CHAPTER 18
SECTION 199A[1]
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Appendix A.18.11

Examples Contained In Proposed Regulations

Chapter 18

SECTION 199A DEDUCTION

18.1 Introduction to the Section 199A Deduction

The Tax Cuts and Jobs Act[2] added Section 199A to the Code.[3] That section provides individuals, estates and trusts conducting a trade or business directly or through a pass-through entity with a significant new deduction (the "Section 199A Deduction"), which in some cases may equal 20% of the net income from the trade or business. On August 8, 2018, the Internal Revenue Service ("IRS") issued Proposed Regulations (REG-107892-18)(the "Proposed Regulations") providing computational, definitional, and anti-avoidance guidance under Section 199A. The discussion below begins with an overview of the Section 199A Deduction, and then takes a more granular look layering in the multiple exceptions and limitations to the basic rules.

A. Persons Who Get the Tax Benefit: Section 199A provides a new deduction for a taxpayer other than a corporation[4] engaging in a trade or business either directly as a sole proprietor[5] or through a partnership, S corporation, or trust or estate that passes through income and loss to its beneficiaries (collectively referred to a Relevant Passthrough Entities, or "RPE").[6] A Section 199A Deduction may also be available with respect to qualified cooperative dividends.[7] This discussion focuses solely on the Section 199A as it applies to individuals conducting trades or businesses directly or through an RPE that is either a partnership or S corporation.

B. The Tax Benefit Defined: An individual's Section 199A Deduction is equal to 20% of the individual's qualified business income a defined in Paragraph 18.6 ("QBI")[8], limited, however, above certain income levels, to the greater of two caps, one of which is determined by reference to W-2 wages and the other by reference to W-2 wages and unadjusted tax basis immediately after the acquisition ("UBIA") of certain qualified property.[9] For individuals with taxable income below certain threshold amounts ($157,500 or $315,000 in the case

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[2] P. L. 115-97.

[3] Unless otherwise stated, all Section references are to the Internal Revenue Code of 1986, as amended.

[4] Section 199A(a). This would include a C corporation and presumably an S corporation to the extent it was subject to taxes under the Code, e.g., the tax imposed by Section 1374 on recognized built-in gain of an S corporation..

[5] This would include an individual that conducted the trade or business through an entity disregarded as an entity separate from the taxpayer, e.g., a wholly-owned LLC.

[6] Note that the Proposed Regulations define an RPE as a partnership (other than a publicly traded partnership) or an S corporation that is owned, directly or indirectly by at least one individual, estate or trust. Also, a trust or estate is treated as an RPE to the extent it passes through QBI (as defined below), W-2 wages (as defined below), and unadjusted basis of qualified property (as defined below), qualified REIT dividend (as defined below) or qualified REIT income (as defined below). Prop. Reg. Section 1.199A-1(b)(9). This Chapter does not address the application of Section 199A to trusts or estates.

[7] Section 199A(a)(2).

[8] The term qualified business income is defined in Section 199A(c)(1) and the Proposed Regulations as the net amount of qualified items of income, gain, deduction, loss with respect to any trade or business as determined under Section 199A(c) and Prop. Reg. Section 1. 199A-3. Section 199A(c)(1); Prop. Reg. Section 1.199A-1(b)(4).

[9] Section 199A(b). Prop. Reg. Section 1.199A-1(c).

of joint return filers)("Threshold Amounts")[10] the caps are ignored, i.e., the deduction is determined simply by reference to QBI.[11] For individuals with taxable income in excess of the Threshold Amount but not in excess of a ceiling ($207,500 or $415,00 in the case of joint return filers)("Ceiling Amount"), the cap limits are phased in, i.e., the amount of the deduction is subject to the limitation of the applicable cap the greater the individual's taxable income exceeds the Threshold Amount. Section 199A also provides for a 20% deduction of the individual's qualified REIT dividend and qualified publicly traded partnership income.[12] In no event may the deduction for eac trade or business exceed 20% of the individual's taxable income after all other deductions—including the standard deduction—and reduced further for net capital gains.[13]

C. Tax Benefit Is Limited to Certain Trades or Businesses: To qualify for the tax benefit, for individual's above the Ceiling Amount, the trade of business conducted by the individual or RPE generally must be a "qualified trade or business,"[14] ("QTB"), which generally is a trade or business other than one providing certain enumerated specified services ("SSTB") such as the practice of law or accounting.[15] For individuals with taxable income below the Threshold Amounts, however, the exclusion for SSTB is ignored.[16] For individuals with taxable income in excess of the Threshold Amounts but not in excess of the Ceiling Amount, the benefit of the Section 199A Deduction is phased out.[17]

D. Only QBI Is Included in Computing the Section 199A Deduction: QBI generally is equal to the individual's net operating income for the year from a domestic trade or business. The net income is reduced by certain items such as investment income and expenses, as well as capital gains and losses including Section 1231 gains and losses.[18]

E. Computing the Tax Benefit With Multiple Trades or Businesses: For individuals with taxable income equal to or less than the Threshold Amount, the QBI for all trades an and businesses (including a SSTB) is aggregated in computing the Section 199A Deduction, and the caps are ignored. For individuals with taxable income greater than the Threshold Amount, generally, the Section 199A Deduction is determined by reference to each separate trade or business, whether conducted directly or indirectly through an RPE, so that the individual must separately determine the QBI, W-2 wages and unadjusted basis of qualified property for each business.[19] As explained below, the individual may in certain instances choose to aggregate separate trades or businesses, other than SSTB, for purposes of calculating

[10] Section 199A(e)(2); Prop. Reg. Section 1.199A-1(b)(11). The Threshold Amounts are adjusted by cost-of-living adjustments. Prop. Reg. Section 1.199A-1(b)(11).
[11] Section 199A(b)(3); Prop. Reg. Section 1.199A-1(c).
[12] Section 199A(b)(1)(B); Prop. Res. Section 199A-1(c).
[13] Section 199A(b)(1); Prop. Reg. Section 1.199A-1(c)(1).
[14] Section 199A(c)(1). The term QTB is defined in Section 199A(d).
[15] Section 199A(d); Prop. Reg. Section 1.199A-3. The complete list of businesses included within the term specified service trade or business is found in Section 199A(d)(2) and Prop. Reg. Section 1.199A-5.
[16] Section 199A(d)(3); Prop. Reg. Section 1.199A-1(c)(1).
[17] Section 199A(d)3; Prop. Reg. Section 1.199A-1(d).
[18] Section 199A(c); Prop. Reg. Section 1.199A-1(b)(4).
[19] Prop. Reg. Section 199A-1(d)(2)(ii). Section 199A did not address aggregation of separate trades or businesses.

the Section 199A Deduction. Aggregation permits the individuals to combine the QBI, W-2 wages and unadjusted basis of qualified property for all the aggregated trades or businesses in computing the caps.[20]. RPEs are responsible under the Proposed Regulations for providing the QBI, W-2 wages, and unadjusted basis of qualified property to its partners.[21] If the RPE fails to provide this information, the QBI, W-2 wages and unadjusted basis is presumed to be zero.[22]

F. Net Losses Offset Net Income from Trades or Businesses: For individuals conducting multiple trades or businesses some of which produce losses, the deduction under Section 199A is available for the year only on the amount by which positive QBI exceeds the negative QBI— the Proposed Treasury Regulations use the term negative QBI to refer to a net loss from a trade or business.[23] Moreover, if the taxpayer has a negative QBI for the year after netting positives and negatives for all of the trades or business, the net negative amount carries over to the succeeding year and is treated as a net negative amount from a trade or business in that year.[24]

G. The Tax Benefit Terminates in 2025: The deduction under Section 199A is available only for taxable years beginning after December 31, 2017, and expires for taxable years beginning after December 21, 2025.[25]

H. The Proposed Regulations provide helpful examples clarifying the complex provisions of Section 199A. Set forth below in Paragraph 18.10 is a detailed review of each example including highlights of the focus of the example and the principles contained therein.

18.2 Ancillary Consequences of Section 199A Deduction

18.2.1 Items Impacted by Section 199A Deduction

There are a number of collateral consequences of the Section 199A Deductions.

(i) In computing an employee's required withholding, the employee may take into account the Section 199A deduction.[26]

(ii) If a taxpayer claims a Section 199A deduction, for purposes of applying the Section 6662 penalty, a substantial understatement of income tax exists if the understatement for the year exceeds 5% of the amount required to be shown on the taxpayer's return.[27]

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[20] Prop. Reg. Section 199A-1(d)(2)(iii).

[21] Prop. Reg. Section 1.199A-6.

[22] Prop. Reg. Section 1.199A-6(b)(3)(iii).

[23] Prop. Reg. Section 1.199A-1(c)(2); Prop. Reg. Section 1.199A-1(d)(2)(ii).

[24] *Id.*

[25] Section 199A(i).

[26] Section 3402(m)(1).

[27] Section 6662(d)(1)(C. Normally the penalty under Section 6662 by reason of a substantial understatement of taxes applies only if the understatement is greater than 10% of the tax required to be stated on the tax return. If a Section 199A Deduction is claimed the penalty applies if the understatement is greater than 5% of the tax required to be stated on the tax return. Whether the understatement is related to the Section 199A Deduction is irrelevant. Prop. Reg. Section 1.199A-1(e)4).

18.2.2 Items Not Impacted by the Section 199A Deduction

The term "taxable income" as used in Section 199A is taxable income as computed by the individual without regard to Section 199A, i.e., the individual first determines taxable income and then determines the amount of the Section 199A Deduction. This rule has the following consequences:

(i) The Section 199A Deduction does not change the individual's adjusted gross income.[28]
(ii) The Section 199A Deduction is available to individuals regardless of whether they itemize deductions and for those that itemize it is available without regard to limits on itemized deductions.
(iii) The Section 199A Deduction is not allowed in computing taxable income for purposes of computing the dividends received deduction.
(iv) In computing the 65% of taxable income limitation for percentage depletion on production from oil and gas wells, taxable income is determined without regard to the Section 199A Deduction.[29]
(v) In computing the percentage depletion limitation of 50% for mineral property (100% for oil and gas property) of the taxable income from the property, taxable income is determined without regard to the Section 199A Deduction.[30]
(vi) The Section 199A Deduction does not impact the taxpayer's calculation of self-employment income or the calculation of the 3.8% tax on net investment income.[31]
(v) The Section 199A Deduction is not included in calculating a net operating loss.[32]
(vi) Taxable income for purposes of calculating the corporate 10% of taxable income limitation for charitable deductions is determined without regard to the Section 199A Deduction.[33]
(vii)In the case of a partnership or S corporation conducting a trade or business, the Section 199A Deduction does not impact the partner's or shareholder's, respectively, adjusted basis in the partner's partnership interest or shareholder's adjusted basis in the shareholder's stock.[34]
(viii) The Section 199A Deduction is determined without regard to any adjustments in computing alternative minimum tax under Sections 56 through Section 59. Section 199(f)(2). [35] The Preamble[36] provides that under these rules a Section 199A Deduction should not cause a taxpayer to be subject to the alternative minimum tax.

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[28]Treas. Reg. Section 1.62-1T(b).
[29] Sect613A(d)(1)(B).
[30] Section 613(a).
[31] Prop. Reg. Section 1.199A-1(e)(2).
[32] Prop. Reg. Section 1.199A-3(b)(1)(v).
[33] Section 170(b)(2)(D)(v).
[34] Prop. Reg. Section 1.199A-1(e)(1).
[35] Section 199A(f)(2); Prop. Reg. Section 1.199A-1(e)(4).
[36] The term Preamble refers to the Preamble of the Proposed Regulations.

18.3 Steps In Computing Section 199A Deduction

Set forth below is a summary of steps for computing an individual's Section 199A Deduction. The terms used in herein are those adopted in the Proposed Regulations, and in some respects vary from certain of the terms used Section 199A. The differences between the terminology of the Proposed Regulations and Section 199A is not substantive, however, and appear to reflect Treasury's attempt to simplify the computation of the Section 199A Deduction. A discussion of the defined terms follows later in this Paragraph.

<u>Step One</u>: The individual must compute his or her taxable income for the taxable year. Recall the individual's taxable income for this purpose is determined without regard to the Section 199A Deduction.[37]

<u>Step Two</u>: For each taxable year, the individual and each RPE must identify each trade or business—including whether it is a SSTB—in which the individual or RPE is engaged.[38]

<u>Step Three</u>: For each trade or business, the individual or RPE, as the case may be, must calculate the QBI for the trade or business for the taxable year, and if the individual's taxable income exceeds the Threshold Amount, the W-2 wages and UBIA for qualified property for the trade or business.[39]

<u>Step Four</u>: The individual determines his or her qualified REIT dividends and the qualified PTP income for the taxable year.[40]

<u>Step Five</u>: If the individual's taxable income is not in excess of the Threshold Amount, the individual's Section 199A Deduction for the taxable year is the sum of: (i) 20% of the positive total QBI (i.e., the sum of the QBI for each trade or business (including any SSTB)); plus (ii) 20% of the positive combined amount of qualified REIT dividends and qualified PTP income; limited, however, to 20% of the individual's taxable income (reduced by net capital gains) for the taxable year.[41] As explained in more detail below, in computing the total QBI, the sum of the positive QBI for each trade or business is reduced proportionately based on positive QBI for all trades or businesses with positive QBI by the negative QBI (i.e., net loss) for each trade or business.[42] If the total QBI is negative, no 20% deduction is allowed under (i) above.[43] Additionally, if the total qualified REIT dividends and qualified PTP income is negative (i.e., an overall net loss), no 20% deduction is allowed under (ii).[44] Any negative amounts in each of clause (i) and (ii) are carried forward to the next year and treated as a negative amount arising in that year from a trade or business or qualified PTP income, as the case may be.

<u>Step Six</u>: If the individual's taxable income for the taxable year is in excess of the Ceiling, the Section 199A Deduction, subject to the caps described below, is the sum of the (i) QBI Component (as defined below) and (ii) the 20% of the combined qualified REIT dividend and qualified REIT income; limited, however, to 20% of the individual's taxable income (reduced by

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[37] Section 199A(e)(1).
[38] Prop. Reg. Section 1.199A-1(c) and Prop. Reg. Section 1.199A-1(d).
[39] Prop. Reg. Section 1.199A-1(d)(2)(iv).
[40] Prop. Reg. Section 1.199A-1(c) and Prop. Reg. Section 1.199A-1(d).
[41] Prop. Reg. Section 1.199A-1(c).
[42] Prop. Reg. Section 1.199A-1(c)(2)(i).
[43] *Id.*
[44] Prop. Reg. Section 1.199A-1(c)(2)(ii).

net capital gains) for the taxable year.[45] If the total qualified REIT dividends and qualified PTP income is negative (i.e., an overall net loss), no 20% deduction is allowed under (ii), and any negative amounts in clause (ii) is carried forward to the next year and treated as a negative amount arising in that year from a qualified PTP income.[46]

The QBI Component is the sum of the following amounts as determined for each trade or business for the taxable year: 20% of the QBI for the trade or business for the taxable year, limited however, to the greater of (i) 50% of the W-2 wages for the trade or business for the taxable year or (ii) the sum of 25% of the W-2 wages plus 2.5% of the UBIA of the qualified property for the taxable year (the amounts referred to in clauses (i) and (ii) are collectively referred to as the "Cap").[47]

In computing the QBI Component for taxable year:

- exclude any QBI, W-2 wages and UBIA for qualified property for the year from a SSTB;[48]

- the individual may if certain requirements are satisfied choose to aggregate trade or businesses with the result that QBI, W-2 wages and UBIA for qualified property of businesses that are aggregated are combined and treated as one trade or business for calculating the QBI Component;[49] and

- if the QBI for a trade or business is negative (i.e., a net loss) the individual must offset—regardless of whether the businesses are aggregated—the positive QBI from other trades or businesses in proportion to the relative amounts of net QBI in the businesses with the positive QBI.[50]

- As discussed above in Step Five, tf the combined QBI from all trades and businesses for the taxable year is a negative amount (i.e., overall net loss and regardless of whether the trades or businesses are aggregated), the QBI Component for the taxable year is zero.[51] Tthe negative amount is carried forward to the next succeeding year and treated as a negative QBI for that year from a separate trade or business.[52] There is no carryover, however, of W-2 wages or UBIA to a succeeding year for purposes of the QBI Component.[53]

  These steps are discussed in Paragraph 18.5.2.1.

<u>Step Seven</u>: If the individual's taxable income for the taxable year is in excess of the Threshold Amount but is not in excess of the Ceiling Amount and the individual includes any QBI from a SSTB, the QBI Component includes the QBI, W-2 wages, and UBIA for qualified property for the SSTB under a phase-in rule, discussed hereinafter in Paragraph 18.5.2.2.3.[54] Essentially, this phase-in rule works to exclude more QBI, W-2 wages and UBIA of qualified property of the

[45] Prop. Reg. Section 1.199A-1(d)(2)(iv)(A).
[46] Prop. Reg. Section 1.199A-1(d)(3).
[47] Prop. Reg. Section 1.199A-1(d)(2)(iv)(A).
[48] Prop. Reg. Section 1.199A-1(d)(2)(i).
[49] Prop. Reg. Section 1.199A-1(d)(2)(ii).
[50] Prop. Reg. Section 1.199A-1(d)(2)(iii)(A).
[51] Prop. Reg. Section 1.199A-1(d)(2)(iii)(B).
[52] *Id.*
[53] Prop. Reg. Section 1.199A-1(d)(2)(iii)(A) and Prop. Reg. Section 1.199A-1(d)(2)(iii)B).
[54] Prop. Reg. Section 1.199A-1(d)(2)(i).

SSTB from the QBI Component the greater the individual's taxable income for the year exceeds the Threshold Amount. The individual must not aggregate any SSTB with any other trade or business, including another SSTB.

Step Eight: If the individual's taxable income for the taxable year is in excess of the Threshold Amount but is not in excess of the Ceiling, after the adjustments, if any, provided in Step 6, the QBI Component is computed as follows. First, calculate the greater of (i) 50% of the W-2 wages for the trade or business for the taxable year or (ii) the sum of 25% of the W-2 wages plus 2.5% of the UBIA of the qualified property for the taxable year.[55] If that amount is greater than 20% of the QBI for the trade or business for the year, the QBI Component is equal to that amount. If however, that amount is less than 20% of the QBI from the trade or business (the "Excess Amount"), the QBI Component is a modified amount. Essentially, in this latter instance, this phase-in rule works such that the QBI Component is 20% of the QBI reduced by the excess amount and the excess amount proportionately increases as the individual's taxable income increases above the Threshold Amount. The phase-in rule is explained in Paragraph 18.5.2.

18.4 Taxable Income Ceiling on Section 199A Deduction

There are two limitations on the amount of the Section 199A Deduction determined by reference to the individual's taxable income for the taxable year. In applying these limitations, it is helpful to remember that in applying this limitations the individual's taxable income is determined without regard to the Section 199A Deduction.[56] Also, an individual's taxable income is computed differently that the individual's QBI. Taxable income includes wages as an employee, capital gains and investment income, while QBI does not.[57] Moreover, taxable income is determined after various deductions such as net operating loss carryover and itemized or standard deductions to name a few, and such losses and deductions do not reduce QBI.[58]

Section 18.4.1 20% of Taxable Income Limitation

The individual's deduction determined under Section 199A with respect to the individual's QBI plus qualified REIT dividends and qualified PTP income cannot exceed 20% of the individual's taxable income for the taxable year (the "20% Ceiling").[59] This limitation is referenced in Steps Four and Five listed in Paragraph 8.2 above for computing the Section 199A Deduction. In determining the individual's taxable income for the taxable year, the taxable income is reduced by net capital gains (which includes qualified dividends)[60] and any qualified cooperative dividends[61]. This limitation operates so that the Section 199A Deduction will be a deduction only against ordinary income and not a deduction against net capital gains taxed at a preferential rate. To illustrate, assume the individual's taxable income for the year before the Section 199A Deduction is $80,000, which amount includes $20,000 of QBI, $70,000 of net capital gain and $10,000 of investment interest income and $20,000 net operating loss ("NOL") carryforward from 2017. The individual's taxable income does not exceed the Threshold Amount. The taxpayer's

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[55] Prop. Reg. Section 1.199A-1(d)(2)(iv)(B).

[56] Section 199A(e)(1).

[57] Section 199A(c); Prop. Reg. Section 1.199A-3(b).

[58] *Id.*

[59] Section 199A(1).

[60] Section 1(h).

[61] Section 199A(1). The reduction in taxable income for qualified cooperative dividends is necessary because the Section 199A Deduction for qualified cooperative dividends is determined under Section 199A(a)(2) separately from the Section 199A Deduction for QBI under Section 199A(a)(1).

Section 199A Deduction before the taxable income limitation is amount is $4,000 (20% multiplied by $20,000 of QBI). However, in this instance, the taxable income limitation applies. For purposes of calculating this limitation, the taxpayer's taxable income of $80,000 is reduced to $10,000 by excluding the net capital gain of $70,000. The taxable income limitation is equal to $2,000 (20% multiplied by the reduced taxable income of $10,000). Thus, the taxpayer's Section 199A Deduction for the year is $2,000.[62] **Practice Point: The individual can use the Section 199A Deduction only as a deduction against ordinary income and cannot use the Section 199A Deduction to shelter net capital gain taxed at a preferential rate. Other deductions that reduce taxable income (e.g., itemized or standard deductions and net operating losses) but that do not reduce qualified business income act to make sure the Section 199A Deduction does not act as an inappropriate shelter or create a NOL.**

Taxable income also exclude qualified cooperative dividends. The 20% deduction for qualified cooperative dividends is separately computed and therefore is excluded from taxable income for purposes of the 20% Ceiling. The deduction under Section 199A equal to 20% of the individual's qualified cooperative dividends for the taxable year cannot exceed the taxpayer's taxable income for the year reduced by net capital gains.[63] This limitation under Section 199A is applied separately to the limitation on the 20% deduction determined by reference to QBI, qualified REIT dividends and qualified PTP income.

Section 18.4.2 Taxable Income Limitation

The second limitation determined by reference to the individual's taxable income is that the Section 199A Deduction as determined for both QBI, qualified REIT dividends and qualified PTP income plus the qualified cooperative dividend cannot in the aggregate exceed the individual's taxable income for the year reduced by net capital gains[64]. **Practice Point: The Section 199A Deduction as determined for both QBI, qualified REIT dividend and qualified PTP plus the amount determined for qualified cooperative dividends cannot create a taxable loss for the year.**

18.5 Calculating Amount of the Section 199A Deduction

The Section 199A Deduction is calculated differently depending on whether the individual's taxable income for the year is equal to or less than the Threshold Amount. Paragraph 8.4.1 provides the calculation of the deduction for the individual whose taxable income for the taxable year is equal to or less than the Threshold Amount. Paragraph 8.4.2 provides the calculation of the Section 199A Deduction for the individual whose taxable income for the taxable year exceeds the Threshold Amount.

18.5.1 Section 199A Deduction: Taxable Income Equal to or Less than Threshold Amount

The Section 199A Deduction for an individual with taxable income[65] for the year equal to or less than the Threshold Amount is equal to the sum of (i) 20% of the Total QBI Amount (as defined below) plus (ii) 20% of the combined amount of qualified REIT dividends and qualified

[62] Please note that this simplified example does not take into account likely deductions such as the standard deduction which would reduce the amount even further.
[63] Section 199A(a)(2).
[64] Section 199A(a)(2)(B).
[65] Note that for this purpose there is no adjustments to taxable income such as for net capital gains.

PTP income.[66] The amount of the deduction is subject to the 20% Ceiling.[67] In making the calculations, the individual must compute: (i) the QBI for each trade or business (which includes SSTB) and (ii) the combined amount of qualified REIT dividends and qualified PTP income. These amounts are determined with respect to trades or business owned directly by the individual and indirectly through a RPE.

Examples illustrating these rules are in Appendix 18.11.1 below.

18.5.1.1 Total QBI Amount

The term "Total QBI Amount" means the net QBI from all trades or businesses conducted directly by the individual plus the individual's distributive share of QBI from trades or businesses conducted through an RPE.[68] The definition of the term "QBI" is set forth in detail in Paragraph 18.6 below.) If the Total QBI Amount is negative (i.e., the individuals had overall net losses), the component of the Section 199A Deduction related to QBI is zero.[69] The negative amount is carried forward to the next succeeding taxable year and is treated for purposes of computing the Section 199A Deduction in that year as a negative amount from a trade or business in that year.[70] If the Total QBI Amount is positive, then it is added to determine the Section 199A Deduction as described in Paragraph 18.5.1 above. The Section 199A Deduction is then compared to the 20% Ceiling and the lesser amounts become the deduction under Section 199A

18.5.1.2 Qualified REIT Dividends and Qualified PTP Income

The term "qualified REIT dividends" means dividends from a REIT other than capital gain dividends (as defined in Section 857(b)(3)) or qualified dividends income (as defined in Section 1(h)(11), i.e., dividends that are taxed as ordinary income rates qualify).[71] However, if the taxpayer has held the REIT stock for fewer than 45 days, the dividends (taking into account the principles of Section 246(c)(3) and (4)) with respect to the stock are not included as a qualified REIT dividend.[72] As explained below, qualified REIT dividends are combined with qualified publicly traded partnership income for purposes of computing the Section 199A Deduction.

The term "qualified PTP Income" means the cumulative income (net profits over net losses for tax years beginning after December 31, 2017) from the publicly traded partnership plus gain attributable to the assets of the PTP from the trade or business that is taxed as ordinary income by reason of the "hot asset" rules under either Section 751(a) or (b).[73] However, only items included as QBI are properly includible in computing qualified PTP income, e.g., items are excluded if foreign sourced, item listed under Section 199A(c)(3)(B), compensation excluded under Section 199A(c)(4) and items related to SSTB.[74]. Also, Section 751(a) or (b) items must satisfy the QBI test as well.[75]

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[66] Section 199A(b)(3); Prop. Reg. Section 1.199A-1(c).
[67] Section 199A(a); Prop. Reg. Section 1.199A-1(c)(1).
[68] Prop. Reg. Section 1.199A-1(b)(12).
[69] Prop. Reg. Section 1.199A-1(c)(1).
[70] Prop. Reg. Section 1.199A-1(c)(2).
[71] Section 199A(e)(3); Prop. Reg. Section 1.199A-1(b)(7).
[72] Prop. Reg. Section 199A-3(c)(2)(B).
[73] Section 199A(e)(5); Prop. Reg. Section 1.199A-3(c)(3).
[74] Prop. Reg. Section 1.199A-3(c)(3)(ii).
[75] *Id.*

If the qualified PTP income for the year is a net loss, that loss is netted with qualified REIT dividends, if any, for the year.[76] The negative amount (i.e., the loss) must be carried forward and used to offset the combined amount of qualified REIT dividends and qualified PTP income in the succeeding year.[77] This carry over rule does not impact the deductibility of the loss for any other provision of the Code.[78] Also, If a loss from a qualified PTP is suspended under Section 469 for a taxable year, it is not otherwise taken into account in that year by the taxpayer in computing the qualified PTP income. For example, a Section 469 suspended loss from one PTP will not be taken into account in that year in computing the taxpayer's qualified PTP ncome, but will be taken into account in a subsequent year in which the losses are no longer suspended by reason of Section 469.[79]

18.5.2 Section 199A Deduction: Taxable Income Exceeds Threshold Amount

If the individual's taxable income exceeds the Threshold Amount, the Section 199A Deduction will be calculated differently depending on whether the taxable income also exceeds the Ceiling Amount.

18.5.2.1 Taxable Income Exceeds Ceiling Amount

If the individual's taxable income[80] for the year exceeds the Ceiling Amount, the Section 199A Deduction is the sum of (i) the QBI Component (as defined in Step Six of Paragraph 18.3) plus (ii) 20% of the combined amount of qualified REIT dividends and qualified PTP income.[81]

18.5.2.1.1 Determining the QBI Component

The QBI Component is equal to the sum of the following amounts determined for each trade or business: 20% of the QBI for the trade or business, provided however, that such amount cannot exceed the greater of (i)50% of the W-2 wages for the trade or business or (ii) 25% of the W-2 wages for the trade or business plus 2.5% of the UBIA of qualified property for the trade or business (the amounts referenced in clauses (i) and (ii) are collectively referred to as the "Cap").[82]

The following computational rules apply in calculating the QBI Component and should be applied in the order they appear.

(i) No QBI, W-2 wages and UBIA attributable to a SSTB are taken into account in computing the Section 199A Deduction.[83]

(ii) The calculation of the QBI, W-2 wages and UBIA for qualified property is determined separately for each trade or business unless the individual chooses to aggregate trades or businesses in the manner permitted by the Proposed Regulations in which case the QBI, W-2 wages and UBIA for qualified property are aggregated for purposes of computing the

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[76] Prop. Reg. Section 1.199A-1(c)(2)(ii).
[77] *Id.*
[78] *Id.*
[79] Prop. Reg. Section 1.199A-3(c)(2)(ii).
[80] Note that for this purpose there is no adjustments to taxable income such as for net capital gains.
[81] Prop. Reg. Section 1.199A-1(d)(2)(iv).
[82] *Id.*
[83] Prop. Reg. Section 1.199A-1(d)(2)(i).

Section 199A Deduction.[84] Aggregation of businesses will be beneficial to an individual conducting directly or indirectly through PREs multiple businesses, and the amounts of QBI, W-2 wages and UBIA of the businesses vary significantly by business. For example, one business has large amounts of QBI but small amounts W-2 wages or UBIA from qualified property and another has smaller amounts of QBI but larger amounts W-2 wages and UBIA from qualified property. When an individual may be permitted to aggregate trades or businesses for this purpose is discussed in Paragraph 8.7.2 below. Aggregation choices are made by the individual for trades or business conducted directly by the individual as well as trades or business conducted indirectly through an RPE, i.e., an RPE does not make aggregation choices.[85]

(iii) A trades or business with a net loss of QBI for the year is treated under the Proposed Regulations as having negative QBI.[86] An individual with more than one trade or business--regardless of whether the businesses are aggregated—must offset positive QBI from one trade or business by the negative QBI from another trade or business.[87] The QBI for each trade or business is calculated after netting positive and negative QBI. The rules for netting are as follows:

- For individual's with more than one trade or business that produce positive QBI and one or more trade or business that produce negative QBI, the negative amount will be apportioned to the positive amounts in proportion to each businesses' positive amount. [Note that because this discussion is addressing individual's with taxable income in excess of the Ceiling Amounts, net losses from a SSTB are not included in making these adjustments.[88]] To illustrate, assume individual A has three trades or businesses, TB-1, TB-2, and TB-3 (none of which are an SSTB). Assume further that before apportioning negative QBI under these rules, the QBI for each is: TB-1 $100, TB-2 $200 and TB-3 ($30). In computing the QBI of TB-1 and TB-2 for purposes of computing the 20% amount, the negative $30 of TB-3 is allocated one-third ($100/$300) to TB-1, or $10, and two-thirds ($200/$300) to TB-2, or $20. Thus, A's QBI under Section 199A(b)(2)(A) is $90 for TB-1 ($100 minus $10) and is $180 for TB-2 ($200 minus $20). **Practice Point: Any negative QBI for a trade or business must be allocated to trades or businesses with positive QBI in proportion to such trade or business' positive QBI. This calculation is done before applying the Cap limitation.[89]**

- If the combined QBI for all trades or businesses for the taxable year is negative, no Section 199A Deduction is allowed for the year. Also, any negative QBI for the year will carry over to the next year to be treated as negative QBI from a separate trade or business, and thus, as a reduction against QBI in the next succeeding taxable year.[90] To illustrate, assume the individual has two trades or businesses, A-1 and A-2, and in year one A-1 has positive QBI of $20,000 and A-2 has negative QBI of $50,000, for a cumulative negative QBI of $30,000. The individual will not

[84] Prop. Reg. Section 1.199A-1(d)(2)(ii).
[85] Prop. Reg. Section 1.199A-4.
[86] Prop. Reg. Section 1.199A-1(d)(2)(iii).
[87] *Id.*
[88] Prop. Reg. Section 1.199A-1(d)(2)(i).
[89] Prop. Reg. Section 1.199A-1(d)((iii)(A). **See Step Six of Paragraph 8.3 for the definition of Cap.** Note that this approach is consistent with that suggested in the New York State Bar Tax Section Report 1392, Report on Section 199A, March 23, 2018 (the "NYSB Tax Report").
[90] Prop. Reg. Section 1.199A-1(d)(2)(iii)(B).

be entitled to a Section 199A Deduction for that taxable year with respect to combined negative QBI amount. Assume further that in year 2, A-1 and A-2 have positive QBI of $20,000 and $60,000, respectively. The carryover negative amount of $30,000 from the prior year is treated as arising from a separate trade or business in the current year. The negative amount must be allocated between A-1 and A-2 in proportion to their respective positive QBI. Accordingly, the individual's positive QBI for A-1 will be $12,500 [$20,000 minus ($20,000/$80,000 multiplied by $30,000)], and for A-2 will be $37,500 [$50,000 minus ($60,000/$80,000 multiplied by $30,000)]. The Senate Report regarding the carryover loss from one year to the next is unclear regarding how to allocate the negative QBI from the prior year. Note, if the individual had aggregate positive QBI in year 1 followed by an aggregate negative QBI in year 2, the loss from year 2 is not carried back to recapture the prior deduction. Thus, the order of the year in which income and losses are recognized impacts the computation.[91] As discussed below, the Proposed Regulation provide rules governing how the loss carryover rule will work when some of the other limitations noted below apply to reduce the deduction below the 20% of QBI. The genitive carryover is presumably indefinite until Section 199A expires. **Practice Point: The Section 199A Deduction for a taxable year is available in its entirety only if the cumulative QBI since for all years beginning after 2017 is not negative.**

18.5.2.2 Taxable Income Within Phase-In Range

Set forth below is a discussion of the calculation of the Section 199A Deduction when the individual's taxable income for the year is within the Phase-In Range, i.e., taxable income for the year exceeds the Threshold Amount but does not exceed the Ceiling Amount.

18.5.2.2.1 Determining the QBI Component

For an individual with taxable income in the Phase-In Range, the QBI Component is determined in the manner provided above with two important adjustments.[92] To understand these adjustments, remember that an individual with taxable income below the Threshold Amount ignores the Cap in computing the QBI Component, and for an individual with taxable income above the Ceiling the Cap sets a potential limit on the QBI Component. With that in mind, the first adjustment phases in, or increase, the application of the Cap in calculating the QBI Component as the individual's taxable income increases above the Threshold Amount. The second adjustment is applicable only for an individual with an interest in a SSTB, and requires the individual to take into account in computing the QBI Component a certain percentage of the QBI, W-2 wages and UBIA from qualified property from the SSTB that increases as the individuals' taxable income increases.[93] After an individual with an interest in a SSTB makes this latter adjustment to determine the QBI, W-2 wages and UBIA from qualified property for the SSTB, the individual makes the first adjustment referenced above to the adjusted amounts of QBI, of W-2 wages, and UBIA from qualified property. These concepts are illustrated below.

18.5.2.2.2 Adjustment to QBI Component For Taxable Income Within The Phase-In Range

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[91] Prop. Reg. Section 1.199A-(1)(d)(2)(iii).
[92] Prop. Reg. Section 1.199A-1(d)(2)(iv)(B).
[93] Prop. Reg. Section 1.199A-1(d)(2)(i).

For an individual with taxable income from a trade or business within the Phase-In Range, the individual determines the QBI Component for the business for the taxable year using the following steps:

(i) Step One: The individual calculates the QBI Component without regard to phase-in rules.

(ii) Step Two: If the Cap for the business is equal to or greater than 20% of the QBI, the QBI Component is equal to 20% of the QBI and no adjustments are required.

(iii) Step Three: If the Cap for the business is less than 20% of the QBI, compute the "Reduction Amount," which is defined as that amount by which the 20% of the QBI exceeds the Cap.[94]

(iv) Fourth Step: The QBI component is equal to the sum of 20% of the QBI minus the Reduction Amount as adjusted. The adjusted Reduction Amount is that amount that bears the same ratio to the Reduction Amount as the individual's taxable income in excess of the Threshold Amount bears to $50,000 or $100,000 for joint return filers. To illustrate, assume an individual filing a joint return and has total taxable income for the year of $400,000, all of which is positive QBI from a trade or business (other than a SSTB) operated as a sole proprietorship. Assume also that for the year the trade or business has W-2 wages of $100,000 and no qualified property. The QBI Component without regard to this adjustment would be $50,000, i.e., although the 20% component is $80,000 (20% multiplied by $400,000), that amount is subject to a lesser Cap and limited to $50,000 (50% of the W-2 wages of $100,000). The individual's Reduction Amount is $30,000 ($80,000 minus $50,000) The individual's Reduction Amount is adjusted to equal an amount that bears the same ratio to $85,000 (the individual's $400,000 of taxable income minus the Threshold Amount $315,000) as the Reduction Amount of the individual's taxable income in excess of the Threshold Amount ($85,000) bears to Adjustment Amount ($100,000). The individual's adjusted Reduction Amount is equal to $25,500 [$25,500 bears the same ratio to $30,000 as $85,000 (the individual's taxable income in excess of the Adjustment Amount) bears to $100,000 (the Adjustment Amount). Thus, the QBI Component is $54,500, (i.e., the sum of $80,000 (20% of $400,000) minus the adjusted reduction amount of $25,500).

18.5.2.2.3 Adjustment to QBI Component For Taxable Income Within Phase-In Range And One or more of the Trades or Businesses Is a SSTB

For an individual with taxable income in within the Phase-In Range, the adjustments for the QBI Component will also depend on whether the individual is engaged directly or indirectly through an RPE in a SSTB.

18.5.2.2.3.1 Individual Engaged Only In A SSTB

An individual with taxable income within the Phrase-In Range must make two adjustment to the QBI Component. The first adjusts the QBI and Cap for purposes of computing the QBI Component for the SSTB. The second adjusts the QBI Component in a manner consistent with Paragraph 18.5.2.2.2. The first adjustment works to decrease the amount of the QBI Component for the SSTB the greater the individual's taxable income exceeds the Threshold Amount.[95] To calculate the QBI Component under these facts, the individual first must calculate the QBI

[94] Prop. Reg. Section 1.199A-1(d)(2)(iv)(B).

[95] Prop. Reg. Section 1.199A-1(d)(2)(i).

Component without regard to this adjustment. Next, the taxpayer multiplies each of the QBI and the Cap (the greater of 50% of W-2 wages or the sum of 25% of the W-2 wages plus 2.5% of the UBIA for the SSTB) by the "applicable percentage." The Proposed Regulations define the term "applicable percentage" as 100% reduced (but not below zero) by the percentage equal to the quotient obtained by dividing the amount by which the individual's taxable income for the taxable year exceeds the Threshold Amount by the Adjustment Amount. The resulting amounts are then used to calculate the QBI Component.

To illustrate these adjustments assume the following facts which are taken from the Proposed Regulations.[96]

Facts: B files a joint return for the year and has taxable income for the year determined without regard to QBI Deduction of $375,000. B owns stock in M, an S corporation. M conducted a SSTB. B's allocable share of QBI from M is $300,000, and B's allocable share of W-2 wages from the trade or business is $40,000. M has no qualified property used in the trade or business. B's taxable income is within the Phase-In Range (i.e, between $315,000 and $415,000), and thus, their QBI Component will be adjusted.

Analysis: The first adjustment is to account for the fact that B's trade or business is a SSTB and B's taxable income is within the Phase-In-Range.

(i) First Step: determine the applicable percentage for B. On these facts B's applicable percentage is 40% [100% minus 60% (which is the quotient obtained by dividing the amount of B's taxable income in excess of the Threshold Amount ($375,000 minus $315,000, or $60,000) by the Adjustment Amount ($100,000)).

(ii) Second Step: Adjust the QBI Component for the Applicable Percentage. The QBI Component adjusted to account for the business's status as a SSTB is: the QBI is $120,000 (unadjusted QBI of $300,000 multiplied by the applicable percentage of 40%) and W-2 wage are $16,000 (unadjusted W-2 wages of $40,000 multiplied by 40%).

Having adjusted to account for M's status as an SSTB, the next steps are to account for the fact that B's taxable income is within the Phase In, and are identical to those discussed above in Paragraph 18.5.2.2.2.

(i) First Step: Using the QBI and Cap as adjusted to account for its status as a SSTB, B's tentative reduction amount is $16,000 (20% of $120,000 QBI, or $24,000, minus $8,000 Cap (50% of $16,000).

(ii) Second Step: Now the Reduction Amount is adjusted because B's taxable income is within the Phase-In Range. The adjusted Reduction Amount is $9,600 (which is the amount that bears the same ratio to $16,000 as B's taxable income in excess of the Threshold Amount, or $60,000, bears to the Threshold Amount, or $100,000). The QBI Component would be $14,400 [($24,000 (20% multiplied by $120,000) minus $9,600 (the adjusted reduction amount].

18.5.2.2.3.2 Individual Engaged in Multiple Trades or Businesses One of which Is a SSTB

[96] Prop. Reg. Section 1.199A-1(d)(4) Example 6.

If the individual engages in multiple trades or business one of which is a SSTB, the QBI Component must be determined for each trade or businesses.[97] If the individual chooses to aggregate trades or businesses, a SSTB cannot be aggregated with any other trade or business.[98] Also, if any trade or business has a negative QBI for the taxable year, the negative must offset the positive QBI of other trades or business in the manner described above. In that regard, whether a negative or positive QBI is from a SSTB is irrelevant to this adjustment.[99]

18.6 QBI – Defined

The term "QBI" is defined to mean for any taxable year the net mount of qualified items of income, gain, loss and deduction with respect to a trade or business. The discussion below first defines what items of income, gain, loss and deduction are included as qualified items, and next addresses what items are expressly not taken into account as qualified items.

18.6.1 Qualified Items

The term "qualified items" means, for an individual the items of income, gain, loss and deduction for the taxable year that are both:

(i) included by the individual in determining taxable income for the taxable year;[100] and

(ii) effectively connected with a domestic trade or business. The "effectively connected" determination is made applying the principles of Section 864(c) by substituting the term "qualified trade or business" for non-resident alien individuals or foreign corporation.[101]

The Preamble makes several points regarding the effectively connected requirement. Any trade or business does not include any type of excluded services listed in Section 864(b)(1), and any item of income, gain, loss or deduction from such excluded service will not be included in determining QBI. Generally, foreign sourced income will not be included in QBI unless the income meets the exceptions provided in Section 864(c)(4)(B). Rather, the item must also be "with respect to" a trade or business." Items of income, gain, loss and deduction that are effectively connected with the conduct of a trade or business in the U.S. is QBI. To illustrate this point, the Treasury notes the Section 871(d) allows a non-resident alien individual to elect to treat income from real property in the U.S. that would not otherwise be effectively connected with the conduct of a trade or business in the U.S., as effectively connected. However, because such items are not attributable to a trade or business (as that term is defined under Section 162), the items will not be included in QBI. Moreover, a deduction allowable in computing effectively connected taxable income may not be includible in QBI. As an example, the Treasury states that Section 873(b) allows deductions including theft losses of property located in the U.S. and charitable contributions under Section 170 to be taken into account in determining effectively connected taxable income. However, these items of deduction would not be includible in QBI because the deductions must be both attributable to a trade or business and also to effectively connected income.

[97] Prop. Reg. Section 1.199A-1(d).
[98] Prop. Reg. Section 1.199A-1(d)(2).
[99] *Id.*
[100] Section 199A(c)(3)(A)(i); Prop. Reg. 1.199A-3(b)(2)(i)(A).
[101] Section 199A(c)(3)(A)(ii); and Prop. Reg. Section 1.199A-3(b)(2)(i)(B).

18.6.2 Items Not Taken Into Account as Qualified Items

18.6.2.1 Qualified REIT Dividends, Qualified PTP Income and Qualified Cooperative Dividends

Qualified REIT dividends and qualified PTP income and qualified cooperative dividends are excluded as a qualified item, and therefrom from the QBI Component[102] However, as noted above, the individual's Section 199A Deduction provides a deduction in addition to the QBI Component of 20% of the individual's qualified REIT dividends and qualified PTP income for year and qualified cooperative dividends. The terms "qualified REIT dividends" and "qualified publicly PTP income" are defined above.

18.6.2.2 Section 1231

All items such as short-term or long-term capital gains and losses (including any item treated as such, e.g., Section 1231 gain) are excluded.[103] Note that prior to the Consolidated Appropriations Act, the exclusions applicable to capital gains or losses was arguably limited to assets held for investment. A change in Section 199A by the Consolidated Appropriations Act removed the word investment as a qualifier for the listed items (i.e., investment items of short- and long-term capital gains). This change appeared aimed at eliminating an argument that net Section 1231 gains treated as capital gains should not be excluded from the computation of QBI. The Proposed Regulation drive the point home stating that any item treated as capital gains or losses by the Code are excluded from the computation of qualified business income, e.g., net gains (composed of gains and losses) treated under Section 1231 as capital gains.[104] However, Section 1231 provides that when Section 1231 gains do no exceed Section 1231 losses and thus result in a net loss, the gains or losses are not treated as capital gains or losses, and accordingly, may be included in the calculation of QBI as ordinary income and loss assuming the gains and losses otherwise satisfy the requirements for inclusion in the definition of QBI.[105] This treatment is explained in an example from the ABA Section of Taxation Comments. Assume an individual conducts two trades or businesses, A and B, neither of which are an SSTB. Assume that A recognizes $90 million of section 1231 gain (as that term is defined in Section 1231) and that B recognizes a $100 million section 1231 loss (as that term is defined in Section 1231). Under Section 1231, the individual nets the 1231 gains and 1231 losses, and because the result is a net loss, the net loss is treated as ordinary loss. In that instance, the qualified items of A and B are determined by including as ordinary income $90 million gain and $100 loss, respectively. However, if you change the facts and assume that B rather than having a $100 million loss instead had a $30 million gain, then under Section 1231, the gain of Business A of $90 million and the gain from Business B of $30 million would be treated as 1231 gain, taxed as long-term capital gain. In that instance, the individual would compute the qualified items for A and B by excluding the 1231 gain. Finally, the Proposed Regulation do not specifically deal with that instance in which the Section 1231 recapture rules apply. To illustrate the issue, consider an individual with businesses A and B. In year one business A recognizes $100 million of 1231 loss and B recognizes $20 million of 1231 gain, or a combined net ordinary loss of $80 million. For that year, under Section 1231 the 1231 gain and 1231 loss are treated as ordinary and are included in the computation of qualified items for A and B. Now assume in year 2, A has a 1231 gain of $50 million and B has a net capital gain of $10 million. Under the Section 1231 recapture rules, the

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102 . Prop. Reg. Section 1.199A-3(b)(2)(ii)(G).
103 Prop. Reg. 1.199A-3(b)(2)(B)(ii)(A).
104 Proposed Regulation Section 1.199A-3(b)(2)(ii)(A)
105 *Id*.

1231 gains of $60 million must be recaptured as ordinary income. The Proposed Regulations do not specifically provide the result in that case but presumably, because the gain are required to be treated as ordinary income under Section 1231, the income would be included as a qualified item.

18.6.2.3 Dividends

Dividend income or income equivalent to a dividend or payment in lieu of a dividend describe in Section 954(c)(1)(G) but excluding amounts described in Section 1385(a)(1) for cooperatives is excluded.[106]

18.6.2.4 Interest

Interest income other than that properly allocable to a trade or business is excluded.[107] This exclusion includes amounts attributable to investment of working capital.[108]

18.6.2.5 Annuities

Annuity income which is not received in connection with a trade or business is excluded.[109]

18.6.2.6 CFC Income

Any items of deduction and loss allocated taken into account under Section 954(c)(1)(C)(transactions in commodities), or section 954(c)(1)D)(excess foreign currency gains) applied in each case by substituting "trade or business" for "controlled foreign corporation" is excluded.[110]

18.6.2.7 Notional Principal Contracts

Any items taken into account under Section 954(c)(1)(C) from notional principals contracts determined without regard to Section 954(c)(1)(D) and any other items attributable to a notional principal contract entered into in a transaction qualifying under Section 1221(a)(7) is excluded.[111]

18.6.2.8 Compensation

Qualified income does not include reasonable compensation paid to the individual by a trade or business for services rendered by the individual with respect to the trade or business.[112] The Proposed Regulations appear to limit this restrictions to S corporation.[113] For an individual operating a trade or business through an S corporation, the individual's qualified income from the S corporation does not include reasonable compensation paid to the individual by the S corporation.[114] However, the deduction for such compensation by the S corporation will be treated

[106] Prop. Reg. Section 1.199A-3(b)(2)(ii)(B)
[107] Prop. Reg. Section 1.199A-3(b)(2)(ii)(C).
[108] *Id.*
[109] Prop. Reg. Section 1.199A-3(b)(2)(ii)(F).
[110] Prop. Reg. Section 1.199A-3(b)(2)(ii)(D).
[111] Prop. Reg. Section 1.199A-3(b)(2)(ii)(E).
[112] Section 199A(c)(4)(A); Prop. Reg. Section 1.199A-3(b)(2).
[113] Preamble; see discussion in Paragraph 18.6.2.9 below.
[114] Prop. Reg. Section 1.199A-3(b)(2)(ii)(H).

as a deduction in computing qualified items assuming it is properly allocable to the trade or business and otherwise deductible.[115] The Senate Report states the rule that qualified income does not include amounts paid by the S corporation that is treated a reasonable compensation. Presumably, if the S corporation paid the individual an amount less than the IRS considered to be reasonable compensation, the IRS could characterize any dividends paid to the individual as compensation, thereby reducing the qualified income for the year. In that regard, the Preamble provides that under the reasonable compensation standard an individual/shareholder-employee is prevented from including reasonable compensation as an amount of qualified income. The Preamble further notes that the phrase "reasonable compensation" is a known standard for S corporations, and moreover, that an S corporation is required to pay reasonable compensation to its shareholder-employee before making dividends payments, citing to Rev. Rul. 74-44, 1974-1 C.B. 287; David E. Watson, P.C. v. United States, 668 F.3d 1008, 1017 (8th Cir. 2012).

18.6.2.9 Guaranteed Payments for Services

Any guaranteed payments under Section 707(c) from a partnership to a partner are not included as qualified income.[116] However, a guaranteed payment for services will be treated as a qualified deduction assuming the amount is properly allocable to the trade or business and otherwise deductible.[117] In May 2018, Treasury officials suggested that the Treasury did not appear inclined to apply a reasonable compensation standard similar to that for S corporations to guaranteed payments by partnerships. The Preamble affirms the conclusion that the reasonable compensation standard does not apply to guaranteed payments for services by partners. In the past, partnerships have not been subject to the reasonable compensation standard applicable to S corporations, and in that respect, the Treasury's apparent position not to apply the standard for purposes of computing qualified income makes sense. Payments to partners for services to the partnership are guaranteed payments under Section 707(c) and reasonable compensation applies to employees. The Preamble notes that under long standing principle a partner cannot be an employee. See Rev. Rul. 69-184, 1969-1 CB 256. The Preamble reminds taxpayers that a guaranteed payment to a partner is not includible as qualified income, but a guaranteed payment is included as a deduction in computing qualified deductions assuming the other general requirements for deductibility are satisfied. The Preamble also highlights that this rule applies to tiered partnerships in which the upper-tier partnership ("UTP") receives a guaranteed payment from a lower-tier partnership ("LTP")(i.e., an entity such as a partnership may be the partner/service provider to a LTP and the recipient of a guaranteed payment). Section 199A(c)(4)(B) does not limit the term partner to an individual, with the result that another partnership or S corporation would be the recipient of a guaranteed payment.[118]

18.6.2.10 Section 707(a) Payments for Compensation

Payments made to a partner other than in his capacity as a partner under Section 707(a) are not included in the computation of qualified business income. Section 199A(c)(4)(C). Prop. Reg. Section 1.199A-3(b)(2)(ii)(J). For example, assume an architect rather than accepting his usual fee for services instead receives a purported interest in a partnership with distribution and allocations that economically mimics the architect's usual fee. Section 707(a) would characterize the purported allocation and distribution as compensation paid to a third party, and as such, any such fee would be excluded from qualified business income. Based on the Preamble it does not

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[115] *Id.*
[116] Section 199A(c)(4)(B): Prop. Reg. Section 1.199A-3(b)(2)(ii)(I).
[117] *Id*.
[118] Prop. Reg. Section 1.199A-3(b)(2)(ii)(I).

appear that the Treasury intends to apply a reasonable compensation standard to Section 707(a) payments. Also, the Preamble states that (as with guaranteed payments for services) the recipient of the Section 707(a) payment may be another partnership or S corporation as well as an individual and in all such cases the amount received is excluded from inclusion in qualified income. *Id*.

18.6.3 Adjustments in Computing QBI

The term "QBI" includes for any taxable year the net amount (which may be positive or negative) of qualified items with respect to a trade or business. Adjustment in computing QBI are specifically addressed in the Proposed Regulations and are set forth below.

18.6.3.1 Wage Expense

Wage expenses are taken into account in computing qualified deductions even though the wages may not have been included in computing the W-2 wage Cap or in QBI itself as discussed in Paragraph 18.6.2.8..[119]

18.6.3.2 Allocation of Item among Multiple Businesses

If an individual, partnership or S corporation conducts multiple trades or businesses, items of QBI that may be properly attributable to more than one such business may be allocated among such businesses using any reasonably method based on all facts and circumstances.[120] Different methods may be use for different items provided that the reasonable method chosen is consistently applied from year to year and clearly reflects the income of each business.[121] Additionally, the overall combination of methods must be reasonable based on all facts and circumstances and records must be maintained in a manner consistent with the allocation method chosen.[122] The Preamble suggest two methods that may be reasonable depending on the facts and circumstances: direct tracing of QBI items to the separate businesses or allocating such items among the businesses based on gross income.

18.6.3.3 Section 751(a) and (b) Gain or Loss

A partner's allocable share of Section 751(a) or (b) gain or loss from assets of the partnership recognized as ordinary income is treated as attributable to the trade or business of the partnership and included in computing QBI. [123]

18.6.3.4 A partner receiving from a partnership a guaranteed payment for the use of the partner's capital is not includible by the partner in computing QBI.[124] However, any deduction incurred by the partnership arising from the payment by the partnership of such guaranteed payment for capital is includible and otherwise deductible in computing QBI assuming the deduction is properly allocable to the trade or business. Note that this conclusion differs from the NYSB Tax Report. That report offers the following example: assume a 50/50 partnership with two partners, A and B. The partnership has $600 of taxable income before considering a

[119] . Prop. Reg. Section 1.199A-3(b)(4).
[120] Prop. Reg. Section 1.199A-3(b)(5).
[121] *Id.*
[122] *Id.*
[123] Prop. Reg. Section 1.199A-3(b)(1)(i).
[124] Prop. Reg. Section 1.199A-3(b)(1)(ii).

guaranteed payment of $800 to A for use of A's capital, and a net loss of $200 after the deduction for the guaranteed payment. The report states that A should have QBI of $$700, i.e., the guaranteed payment of $800 less A's one-half of the net loss of $200, or $100. Under the Proposed Regulations, A would have a negative QBI of $$100 (one-half of the partnership's net loss of $200). This puts additional pressure on what constitutes a guaranteed payment for capital under Section 707(c).

18.6.3.5 Section 481 Adjustment

Any Section 481 adjustments (positive or negative) are taken into account in computing QBI provided that the adjustment otherwise satisfies the requirements of Section 199A and arises in a taxable year ending after December 31, 2017.[125]

18.6.3.6 Suspended Losses

A suspended loss under Sections 465, 469, 704(d) or 1366(d) with respect to a trade or business will not be included in the QBI for the year because the item is not included in computing taxable income for the year.[126] However, in the taxable year in which the suspended loss is allowed, such loss will be included in computing QBI for that year.[127] If such losses were carried over from a taxable year ending before January 1, 2018, such losses are not included in the computation of the QBI.[128] Presumably, the character of the items included in the suspended losses and attribution to a particular trade or business will be the same when the losses are no longer suspended. See ABA Section of Taxation Comments, Treatment of Losses and Certain Other Issues Regarding the Section 199A Deduction, July 23, 2018.

18.6.3.7 NOLs and Section 461(l)

Treatment of NOLs and losses suspended under Section 461(l) are separately addressed in the Proposed Regulations.

18.6.3.7.1 NOLs

Items included in determining an operating loss for a taxable year that create a NOL for a trade or business are take into account in determining taxable income for that year, and thus, are included in the computation of QBI for the business for that year.[129] The NOL created by such operating losses is a carry forward under Section 172 to a subsequent year, but is not considered in determining the QBI in any later year.[130] The Preamble explains that because items that give rise to an NOL are allowed in computing taxable income for the earlier year in which the operating loss was created, the NOL resulting from such loss should not be taken into account in computing the QBI in a later year "otherwise, the loss could be taken into account in multiple tax years."

18.6.3.7.2 Section 461(l)

[125] Prop. Reg. Section 1.199A-3(b)(1)(iii).
[126] Prop. Reg. Section 1.199A-3(b)(2)(i)(B).
[127] Prop. Reg. Section 1.199A-3(b)((1)(iv).
[128] *Id.*
[129] Prop. Reg. Section 1.199A-3(b)(2)(i)(B).
[130] Prop. Reg. Section 1.199A-3(b)(1)(v).

Losses disallowed under Section 461(l), merit different treatment than that provided for NOLs.[131] Under Section 461(l) the "excess business loss" is not allowed in computing taxable income for the year but is treated as a NOL to be carried forward to the next succeeding year. Because losses disallowed under Section 461(l) that are included in an NOL, that portion of the NOL attributable to such disallowed losses will constitute an item includible in computing QBI to the extent the other requirements of section 199A and the Proposed Regulations are satisfied. Borrowing from an example in the ABA Section of Taxation Comments, assume that in year 1 individual A has $100 million of non-businesses income and a $50 million net loss from a trade or business. Assume that in year 2, A has non-business income of $100 million and $130 million of net income from the trade or business. In that instance, ignoring the adjustment under Section 461(l) for the $250,000 (or $500,000 if a joint return is filed) against which the trade of business loss may be used, Section 461(l) would provide for "excess business losses" of $50 million all of which would be treated as an NOL to year 2. In year 1, A has no Section 199A Deduction because the QBI is zero. In year 2, the $50 million of NOL is treated as a operating loss included in computing the QBI from the trade or business for year 2 or $80,000,000, i.e., $130,000,000 minus $50,000,000 of additional operating loss. The ABA Section of Taxation Comments note that there are a number of questions regarding the computation of the 461(l) deductions for a taxpayer with multiplied trades or businesses where one may be a SSTB and another a trade or business other than a SSTB. For example, the term "excess business loss" is defined in Section 461(l) to be the excess of the aggregates deductions from all trades or businesses over the aggregate gross income or gain for such year plus $250,000 (or $500,000 for a joint return). If the taxpayer has both a non-SSTB and a SSTB and the SSTB creates a net loss that when aggregated with the non-SSTB creates an "excess business loss," there is a question about how the amount of deductions for each business that should be included in the "excess business loss." Depending on the methodology, this could impact the Section 199A Deduction for the year. It is not clear whether the Proposed Regulations fully address the ABA's concerns.

18.7 Trade or Business Defined

Only QBI from a trade or business is available in computing the Section 199A Deduction. The Code and the Proposed Regulations use different terms in describing the treatment of trades of businesses in computing the Section 199A Deduction. In Section 199A(b)(2), the Section 199A Deduction is determined, in part, by reference to QBI with respect to a qualified trade or business. Section 199A(c) and Section 199A(d) define the terms “QBI” and “qualified trade or business”, respectively. Section 199(d)(1) defines the term “qualified trade or business” as any trade or business other than a SSTB or trade or business of performing services as an employee. Section 199A(d)(3) provides that a SSTB shall be treated as a qualified trade or business for individual’s with taxable income under the Threshold Amount and partially under the phase-in rules discussed above. Presumably to simplify drafting, the Proposed Regulations do not use the term “qualified trade or business.” Both in Section 199A and the Proposed Regulations, QBI is determined for all trades or businesses including a SSTB. The QBI for a SSTB under the Proposed Regulations is subject to the same limitations in computing the Section 199A Deduction as that provided in the Code, i.e., no Section 199A Deduction is allowed for an individual with QBI from a SSTB if the individual’s taxable income is above the Ceiling Amount and the deduction is subject to the phase-in rules for if the individual’s taxable income is within the Phase-In Range. By substituting the term “trade or business” for the term “qualified trade or business,” the Proposed Regulations can apply all of the rules applicable to the determination of QBI to all trades or business regardless of whether one is a SSTB.

[131] Prop. Reg. Section 1.199A-3(b)((1)(v).

18.7.1 Trade or Business Defined

Section 199A does not define the term "trade or business" and the legislative history under that section is silent regarding how the term is to be defined. The Proposed Regulations fill that void by providing that the term "trade or business" has the same meaning for purposes of Section 199A as the term has under Section 162, but with one caveat.[132] For purposes of Section 199A, the term trade or business includes the rental or licensing of tangible or intangible property that would not otherwise rise to the level of a trade or business under Section 162 provided that the property is rented or licensed to a trade or business that is commonly controlled within the meaning or Prop. Reg. Section 199A-4(b)(1) and meets certain additional requirements.

18.7.2 Aggregation of Multiple Trades or Businesses

The Preamble notes that a taxpayer may be engaged in more than one trade or business for purposes of Section 162 and references Treas. Reg. Section 1.446-1(d)(1) for purposes of defining separate trades or businesses. While the Preamble states that, for purposes of computing the Section 199A Deduction, the Treasury rejected allowing aggregations of trades or businesses using the Section 469 grouping rules, the Treasury believes some aggregation of trades or businesses in appropriate, and has provided in Prop. Reg. Section 1.199A-4 rules permitting aggregation when certain requirements are satisfied. Aggregation is elective under the Proposed Regulations, that is the taxpayer is not required to aggregate multiple trades or businesses. The Preamble highlights that the decision to aggregate multiple businesses is done at the individual taxpayer level and not at the RPE level.[133] In that regard, the Proposed Regulations specifically provide that the rules "allow only individuals to aggregate trades or business."[134] In other words, if a partnership has multiple trades or businesses, that partnership cannot choose to aggregate the businesses. Instead, the individual owners of the partnership make the decision whether to aggregate those businesses operated through the partnership for purposes of Section 199A.

18.7.2.1 Requirements For Aggregation

To aggregate two or more trades or businesses, the individual must demonstrate that the following requirements are met.

(i) No SSTB may be aggregated with any other trade or business including another SSTB.[135] Even if the individual's taxable income is below the Threshold Amount, the individual cannot aggregate items from a SSTB with any other SSTB or with non-SSTB.

(ii) The individual must demonstrate common control of the trade or businesses to be aggregated.[136] Common control requires that the same person(s), directly or indirectly, own more than 50% of each trade or business to be aggregated. For an S corporation with the trade or business, this means ownership by the same person or person(s) of 50% or

[132] See Prop. Reg. Section 1.199A-1(b)(13).
[133] Prop. Reg. Section 1.199A-4(a)
[134] *Id.*
[135] Prop. Reg. Section 1.199A-4(b)(iv).
[136] Prop. Reg. Section 1.199A-1(b)(1)(i).

more of the issued stock, and for a partnership, ownership by the person or person(s) of 50% or more of the capital or profits.[137]

Note for partnerships, the 50% or more test does not require ownership of both capital and profits interests, but rather a 50% or more of either capital or profits interests can satisfy the test.

In determining common control by more than one person, the Proposed Regulations do not refer to the constructive ownership rules in either Sections 267 or 318, but instead provide a separate set of constructive ownership rules. Under those rules, a spouse (other than one legally separated) is deemed to own the interests of the other spouse. Also, an individual is considered to own the interests owned by the individual's children, grandchildren and parents.[138] To illustrate, assume individual A and an unrelated S corporation, X, own 1% and 99%, respectively of the capital and profits interests in partnership Y that conducts a trade or business. Assume that X, A, and B, A's son, own 1%, 1% and 99% of the capital and profits interest of partnership Z that conducts a trade or business. A would be permitted to aggregate the trades or businesses of X because A is deemed to own B's share of profits and capital in partnership Z, and thus, the same persons would own more than 50% of the profits and capital of both Y and Z.

What is not specifically addressed is the manner in which partnership interests in a lower-tier may be attributed to the individual owners of an upper-tier partnership for purposes of applying this common control rule. More specifically, how is the QBI, W-2 wages and UBIA allocated from the partnership conducting the trade or business to the partnership's partners for purposes of the partners that are individual's calculation of the Section 199A Deduction? This trade or business could be conducted either by the partnership in which the individual has the direct interest or through a lower-tier partnership in the upper-tier partnership which has an interest. But for purposes of determining the ownership in the lower-tier partnership for purposes of the common control requirement, the rules are a mystery. Is it the ownership interest in the upper-tier partnership in which the individual as a direct interest, or is it an attributed interest in the lower-tier partnership conducting the trade or business? The Proposed Regulations in stating the common control test do provide that entities may be aggregated if an individual can demonstrate that the same persons or group of persons either directly or indirectly own 50% or more of the interests to be aggregated. Prop. Reg. Section 1.199A-4(b)(1)(i). To Illustrate this point, assume individual A owns 51% of the profits and capital interests in upper-tier partnership X and that X owns 49% of the profits and capital interest in lower-tier partnership Y and that Y conducts a trade or business. Assume also that A owns 100% of the stock of an S corporation that conducts a trade or business. Are the trades and business of X and the S corporation under common control? Can A aggregate the trade or business of the S corporation with the trade or business conducted by the lower-tier partnership Y? A owns more than 50% of the upper-tier partnership X but if you attribute the profits and capital interests X owns in Y, 49%, to A in proportion to As ownership of X, A will own less than 50% of the profits and capital interests in the lower-tier partnership Y (e.g. 51% of 49%).

(iii) Each trade or business to be aggregated must be a trade or business within the meaning of Prop. Reg. Section 1.199A-1(b)(13).[139] This is a controversial rule in that one cannot aggregate activities that combined could constitute a trade or business but separated

[137] *Id.*

[138] Prop. Reg. Section 1.199A-4(b)(3).

[139] Prop. Reg. Section 1.199A-4

might not—such as an apartment building subject to a triple net lease held in one RPE and a management activity that oversees the apartment building held in another RPE.

(iv) The aggregated trades or business must be on the same taxable year, except in the case of a short taxable year.[140] For example, if individual A owns 51% of the profits and capital of a partnership with a June 30 year end and A conducts a trade or business as a sole proprietorship with a December 31 year end, A could not aggregate the trades or businesses. Consider the same facts except that the partnership is on a calendar and terminates its operations in January. Even though the partnership in the year it is liquidated has a short taxable year that ends other than on December 31, A may aggregate the trade or business for that short taxable year with the trade or business A conducts as a sole proprietorship.

(v) The common ownership of each aggregated trade or business must exist for at least a majority of the taxable year in which the items of each business is included in income.[141] Presumably, the reference to the taxable year means the taxable year of the common owners. For example if individual A, a calendar year taxpayer, owned 60% of the stock of two S corporations, in order to aggregate the trades or business of the corporations A would be required to own the stock of both corporations for more than 6 months in each relevant calendar year of the taxpayer. It is not clear how short taxable years would be addressed, although the most plausible interpretation is that the reference to a taxable year includes any short taxable year as well.

(vi) Finally, the trades or businesses to be aggregated must satisfy at least two of the following requirements:[142]

- each of the trades or business provide services or products that are the same or commonly offered together;[143]

- the trades or businesses share facilities or significant centralized business elements such as accounting, personnel, legal, Human Resources or information technology;[144] or

- the trades or businesses are operated in coordination with, or reliance upon, one or more of the other aggregated businesses (e.g., supply chain interdependence).[145]

The Preamble notes that these requirements are necessary to demonstrate the businesses to be aggregated are "part of a larger, integrated trade or business."

18.7.2.2 Items Aggregated

Assuming aggregation of multiple trades or businesses is permitted, what gets aggregated? Aggregation allows the individual to include the W-2 wages and UBIA for all aggregated businesses in applying the Cap. An individual may aggregate such items from a trade

[140] Prop. Reg. Section 1.199A-4(b)(iii).
[141] Prop. Reg. 1.199A-4(b)(ii).
[142] Prop. Reg. Section 1.199A-4(b)(1)(v).
[143] Prop. Reg. Section 1.199A-4(b)(1)(v)(A).
[144] Prop. Reg. Section 1.199A-4(b)(1)(v)(B).
[145] Prop. Reg. Section 1.199A-4(b)(1)(v)(C).

or business conducted either directly by the individual through a sole proprietorship or with a trade or business conducted through an RPE. Individual owners of an RPE are not required to aggregate trades or business of the RPE in the same manner.[146] To illustrate, assume individual A and B own all of the profits and capital interests in a partnership that conducts multiple trades or business and that all of the requirements to aggregate are satisfied. A may choose to aggregate one or more of the businesses, and B may choose not to aggregate the businesses or to aggregate them in a different grouping. To further illustrate the rule, assume individuals A and B own all of the stock of two S corporations and that both corporations conduct a trade or business. Assume that all requirements to aggregate are satisfied. A could choose to aggregate the businesses conducted through the corporations while B could choose not to aggregate.

18.7.2.3 Reporting Requirements

The individual must follow reporting and consistency requirements for aggregation.[147]

(i) Trades or businesses once aggregated must continue to be aggregated in subsequent taxable years. However, if a trade or business no longer qualifies for aggregation under the rules outlined above, such business is excluded (e.g., a trade or business is sold or no longer meets the three factors for aggregation). The rule is written in such a fashion suggesting that if the aggregation requirement is not satisfied for the trades or business for a particular year, the individual must reapply the aggregation test to determine new permissible aggregation. What is curious about this provision is that it suggests if one business is disaggregated the taxpayer gets to reapply the aggregation rules, perhaps choosing the same grouping or not.[148]

(ii) An individual is permitted to add (at the individual's choice) to an existing aggregation a newly acquired (whether in a taxable or tax-free acquisition) or created trade or business.

(iii) For each taxable year, the individual must attach to the individual's tax return a statement: (i) identifying the aggregation; (ii) a description of each entity in the aggregation; (iii) the name and EIN of each entity; (iv) list any trade or business formed, terminated, or acquired or disposed of during the year; and (v) such other information as required in forms or instructions or published guidance**.**[149] **Practice Point: Failure to attach the required information to a tax return permits the IRS (at its discretion) to disaggregate the individual's trade or businesses. Prop. Reg. Section 1.199A-4(c). It is unclear whether the IRS must either disaggregate all of the businesses or can pick and choose which to disaggregate.**

18.7.2.4 Effective Dates

Generally, the aggregation rules apply to years ending after the date the Treasury decision adopting the rules is issued as final regulations published in the Federal Register. However, taxpayers may rely on the regulations until the date the Treasury adopts the regulations as final regulations.[150] Additionally, if a partnership's or S corporation's taxable year is a straddle year that begins before January 1, 2018 and ends after December 31, 2017, an individual's share of

[146] Prop. Reg. Section 1.199A-4(b)(2).
[147] Prop. Reg. Section 1.199A-4(c).
[148] Prop. Reg. Section 1. 199A-4(c).
[149] Prop. Reg. 1.199A-4(c)(2).
[150] Prop. Reg. Section 1.199A-4(e)(1).

items from such entity are treated as incurred by the individual for his taxable year in which or with which the entity year's ends.[151] For example assume a calendar year individual with an interest in a partnership that has a June 30 year end. For 2018, the individual may include all of the QBI, W-2 Wages and UBIA as incurred for 2018. The individual is not required to apportion the items for the straddle year between 2017 and 2018.

18.8 Trade or Businesses that do not qualify for the Section 199A Deduction

18.8.1 SSTB

If an individual's taxable income for the taxable year equals or exceeds the Ceiling Amount, no Section 199A Deduction is permitted with respect to a SSTB conducted by the individual directly or indirectly through an RPE.[152] If an individual's taxable income for the taxable year is less than the Ceiling Amount but in excess of the Threshold Amount, a Section 199A Deduction is available with respect to the SSTB conducted by the individual directly or through an RPE, but in an adjusted amount as explained in Paragraph 18.5.2.2.3.[153] Finally, if an individual's taxable income for the taxable year is equal to or less than the Threshold Amount, a Section 199A Deduction is available and is determined without regard to any Cap limitation as explained in Paragraph 18.5.1.[154] These limitations reflect Congress' intent not to give a tax break to certain high earning owners of service businesses— such as medical, law or accounting firms. Additionally, as explained above, no Section199A Deduction is available with respect to wage income in any circumstance. Performing services as an employee is not a trade or business for purposes of Section 199A. Prop. Reg. Section 1.199A-5(a)(3).

Even if an individual is an owner in a RPE that is operating a SSTB but is not directly involved in the provision of such services, the activity is nonetheless a SSTB for that individual.

The term "SSTB" is one that is included within one of two of the following categories: (i) a business defined in Section 1202(e)(3)(A) excluding however the trade or business of engineering and architecture, and (ii) a business of investing, investment management, trading, or dealing in securities, partnership interests or commodities. Each is discussed in turn below.

18.8.1.1 SSTB Includes Trade or Business Defined in Section 1202(e)(3)(A)

The first category is a trade or business described within Section 1202(e)(3)(A), excluding, however, the business of architecture and engineering. Thus, trades or businesses described in Section 1202(e)(3)(A) as a SSTB are those in the field of: health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services and any business where its principal asset is the skill or reputation of one or more employees. As discussed below, the Proposed Regulations define what type of services are included within one of the enumerated fields.[155]

Except for several private letter rulings, there is no published guidance from the Treasury on what services will be captured within the field of services listed in Section 1202(e)(3)(A).

[151] Prop. Reg. Section 1.199A-4(e)(2).
[152] Prop. Reg. Section 1.199A-1(d)(2)(i).
[153] Prop. Reg. Section 1.199A-1(d)(2)(i).
[154] Prop. Reg. Section 1.199A-1(c).
[155] Prop. Reg. Section 1.199A-5.

Similar services are included in Section 448 that qualify for the use of the cash method of accounting. Treasury Regulation Section 1.448-1T(e) is instructive in determining for purposes of Section 448 the meaning of services in the field of health and consulting. It is unclear whether the authority referenced above under Section 448 is helpful in defining a SSTB. The Senate Report references the Treasury Regulations under Section 448 for purposes of further defining services within the field of health, performing arts and consulting. The Conference Report states that it follows the Senate Report. The Proposed Regulations provide that the rules contained therein cannot be taken into account by taxpayers in applying any other provision of law or regulations unless such provision specifically refers to Section 199A or Prop. Reg. 1.199A-5.[156] In that regard, presumably the IRS did not want taxpayers to use the language from the Proposed Regulations in interpreting Section 448 and Section 1202. The Preamble does say that, "consistent with ordinary rules of statutory construction, the guidance in [Prop. Reg. Section 1.199A-5(b)] is informed by existing interpretations and guidance under both Sections 1202 and 448 when relevant." It is clear from the Preamble that where appropriate the Treasury drew upon existing guidance of those Sections for purpose of the Proposed Regulations.

The Preamble makes clear that in determining whether a service business is within the definition of SSTB is based on all "relevant indicia and is not controlled by state licensing laws." For example, an individual may be operating a trade or business in the field of accountancy even though the individual and his staff are not licensed as certified public accountants.

Set forth below is an explanation of the Proposed Regulations' description of the trades or businesses included within the fields of service under Section 1202(e)(3)(A).

18.8.1.1.1 Performance of Services in Field of Health

The Proposed Regulations provide that the field of health means the provision of medical services by individuals (e.g. physicians, nurses, etc.) directly to a patient.[157] Services that are not directly related to medical services even though they may be related to the health of the service recipient are excluded, e.g. spa, health club, account or payment processing, research or testing and manufacturing.[158] This language is very similar to Treas. Reg. Section 1.448-1T(e)(4)(ii). It would appear that management service organizations that provide various services under a management services organization to a medical group is not providing services in the field of health because it is not providing services directly to a patient. Another interesting question is raised by the following example. Assume a partnership is engaged in an air ambulance service. Is that business a SSTB? Does it matter if the service is regulated as a health care provider? Does it matter if the service is required to provide medical services in connection with each flight? As discussed below, the Proposed Regulations provide a *de minimis* rule that, generally, provides that a trade or business with gross receipts of $25 million or less will not be treated as a SSTB if less than 10% of the gross receipts of the trade or business are attributable to the performance of services in one the proscribed fields.[159] Query whether in the air ambulance service above, one can bifurcate the activities between providing the taxi service from the provision of medical service for purposes of applying this rule.

18.8.1.1.2 Performance of Services in Field of Law

[156] Prop. Reg. Section 1.199A-5(b)(2).
[157] Prop. Reg. Section 1.199A-5(b)(2)(ii).
[158] *Id.*
[159] Prop. Reg. Section 1.199A-5(c)(1); Paragraph 18.8.1.3 below.

The Proposed Regulations provide that the field of law means the performance of services by an individual such as lawyers, paralegals, mediators and similar professionals, but does not include ancillary services that do not require skills unique to the field of law used by such professionals, such as printing, delivery service or stenographer service.[160]

18.8.1.1.3 Performance of Services in the Field of Accountancy

The Proposed Regulations provide that the field of accounting means the performance of services by individuals such as accountants, enrolled agents, return preparers, financial auditors and similar professionals performing services in their capacity as such.[161] The Preamble provides that the definition is meant to capture the common understanding of the field of accounting even though the service may not require training or certification as a CPA. The field does not include payment processing and billing analysis and other types of back-office support.

18.8.1.1.4 Performance of Services in Field of Actuarial Science

The Proposed Regulations provide that the field of actuarial science means individuals performing services as actuaries and similar professionals performing services in their capacity as such.[162] The Preamble provides that the field does not include "provision of services by analysts, economists, mathematicians, and statisticians not engaged in analyzing or assessing the financial costs of risk or uncertainty of events."

18.8.1.1.5 Performance of Services in the Field of Performing Arts

The Proposed Regulations provide that the field of performing arts means the performance of services by individuals who participate in the creation of performing acts such as actors, singers, entertainer, directors and similar professionals performing services in their capacity as such.[163] Those individuals performing ancillary services to those in the performing art are not themselves engaged in performing art, e.g., stage hands, maintenance workers or those involved in the broadcast or dissemination of video or audio. Some have noted an inconsistency here as directors are included even though they are arguably not directly involved in the performing arts. The Preamble emphasizes that the field does not include services that do not require skills unique to the creation of performing arts. Interestingly, Treas. Reg. Section 1.448-1T(e)(4)(iii) notes that the field of performing arts does not include service of athletes. Section 448 list of personal services does not include athletes as a covered personal service while Section 1202(e)(3)(A) lists athletes in addition to artists as discussed below in Paragraph 18.8.1.1.8.

18.8.1.1.6 Performance of Services in the Field of Consulting

The Proposed Regulations provide that the field of consulting means the provision of professional advice and counsel to clients to assist in achieving a goal or solving problems.[164] It also includes advice regarding advocacy with the intention of influencing governmental agencies, legislators or other governmental officials and similar professionals performing services in their capacity as such.[165] The Preamble also notes that the definition of consulting for Section 199A

[160] Prop. Reg. Section 1.199A-5(b)(2)(iii).
[161] Prop. Reg. Section 1.199A-5(b)(2)(iv).
[162] Prop. Reg. Section 1.199A-5(b)(2)(v).
[163] Prop. Reg. Section 1.199A-5(b)(2)(vi).
[164] Prop. Reg. Section 1.199A-5(b)(2)(vii).
[165] *Id.*

purposes is "informed by the definition" of that term under Section 448. The wording of the Proposed Regulations is somewhat similar to but not identical to Treas. Reg. Section 1.448-1T(4)(iv). In the Proposed Regulations, a consulting service does not include sales or economically related services or training or teaching. Whether services fall within the preceding sentence will be based on facts and circumstance including how compensation is determined. Note that Treas. Reg. 1.448-1T(4)(iv) provides that a service for which a fee is contingent on completing a transaction would appear to look less like consulting and more like sales or an economically related service

The Proposed Regulation state that consulting services do not include the performance of consulting that is embedded within, or ancillary to, the sale of goods or performance of services in a businesses that is not otherwise a SSTB, and for which the business is not separately compensated for the consulting component.[166] The Proposed Regulations provide two examples illustrating this exception. In the first example, a building contractor provides consulting on design work offered in connection with a building project and for which the consulting service is not separately charged. In the other example, a business sells computers but also provides consulting services to customers in the setup and installation of the computers. Even if the consulting service is charged separately, the Proposed Regulations provide that the consulting service will not taint the other business if consulting activities conducted as part of another business satisfies a "de minimis" rule, which is discussed below.[167] Finally, there is an example in the Treasury Regulations under Section 448, which included financial services within the general category of consulting services. Specifically, the Treasury Regulations under Section 448 provides an example illustrating services of consulting versus services as a broker. See Treas. Reg. Section 1.448-1T(e)(iv)(B) Example 5. Under Section 199A unlike Section 448, financial services are a separately stated SSTB.

18.8.1.1.7 Performance of Services in the Field of Financial Services

The Proposed Regulations provide that the field of financial services include managing wealth for client and advising clients regarding finances, retirement, wealth succession planning, advisory services regarding valuation, mergers, acquisitions, dispositions, and bankruptcy restructuring, raising capital by underwriting, acting as a client's agent for the issuance of stock or other securities and similar services.[168] The Preamble provides that the field of financial services does not include banking or otherwise taking deposits or making loans. In that regard, the Preamble highlights that the field of financial services is listed in Section 1201(e)(3)(A) and that banking is separately listed in Section 1202(e)(3)(B), which the Preamble states supports the inference that banking is not part of financial services. There are instances in which the field of consulting and financial services are different services but it seems that there are instances in which the fields overlap. Whether the fields do overlap does not appear to be particularly troubling because both are a SSTB and there does not appear to be a reason to distinguish between fields of service.

18.8.1.1.8 Performance of Services in the Field of Athletics

The Proposed Regulations provide that the field of athletics means the performance of services by individuals that participate in athletic competition such as athletes and coaches and

[166] Prop. Reg. Section 1.199A-5(b)(2)(vii).
[167] Prop. Reg. Section 1.199A-3(c).
[168] Prop. Reg. Section 1.199A-5(b)(2)(ix).

team managers in sports such as football, baseball, basketball, soccer, hockey martial arts, boxing bowing, tennis, golf, skiing, snowboarding, track and field, billiards and racing. Presumably this category is not limited to the list outlined above.[169] Support services to those activities are excluded from the field, however. Support services are those that do not require "skills unique to athletic competition" such as maintenance and operation of equipment as well as participating in broadcast or audio of athletic events. The Preamble notes that the field of athletics is not listed in Section 448 and there is sparse guidance on what it means for purposes of Section 1202. But, the Preamble provides that the field of athletics is most similar to the field of performing arts.

18.8.1.1.9 Performance of Services in the Field of Brokerage Services

The Proposed Regulations provide that the field of brokerage services includes arranging transactions between a buyer and seller with respect to securities (as defined in Section 475(c)(2)) for a fee or commission. However, real estate agents and brokers as well as insurance agents and brokers are specifically excluded.[170]

18.8.1.1.10 Any Trade or Business in which the Principal Asset is Reputation or Skill of an Employee or Owner

A SSTB includes any trade or business in which the reputation or skill of one or more employees or owners is a principal asset of the business.[171] This business is also referenced in Section 1202(e)(3)(A). The Preamble explains at length the conundrum presented in trying to define the term in a way that was not overly broad and so the Proposed Regulation were drafted to provide a "narrow set of trades or businesses" to be encompassed within the term. In that regard, the term is limited to a trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners engaged in: (i) a business in which a person receives compensation, fee or other income for endorsements of a product or service; (ii) a business in which the person licenses or receives compensation, fee or other income for the use of an individual's image, likeness, name, signature, voice, trademark, or other symbols associated with individual's identity; or (iii) a business of receiving a fee, compensation or other income for an appearance at an event or on any media format.[172]

The term "compensation, fee or other income" covers a receipt of a profits interest in a partnership and distributive share of profits from such interest, or receipt of stock of an S corporation and distributive share of profits from such stock.[173]

Clearly the Proposed Regulations have significantly narrowed the reach of this category of service for purposes of Section 199A(d)(2)(A). To illustrate this point, consider a real estate developer that in addition to his business of building, owning and selling various projects also operates ancillary businesses such as leasing and asset management activities. It might be argued that the developer’s name and reputation is essential to those businesses. The Proposed Regulations make clear that such business was not one intended to be included by reason of this

[169] Prop. Reg. Section 1.199A-5(b)(2)(viii).
[170] Prop. Reg. Section 1.199A-5(b)(2)(x).
[171] Prop. Reg. Section 1.199A-5(b)(2)(xi).
[172] *Id.*
[173] *Id.*

provision.[174] If, however, a developer licenses his name, for example, to a casino or hotel, thn that licensing activity would be a SSTB. Note that while asset management was included as a SSTB by reason of Prop. Reg. Section 1.199A-5(b)(2)(xi)(which is discussed below) that same clause specifically stated that directly managing real property was not intended to be included within the phrase "investment or asset management."Finally, by limiting the scope of a trade or business in which a principal asset was the skill or reputation of one of the owners or employees, Treasury avoided a question of whether an architecture or engineering business that was intended to be excluded from the definition of SSTB was nonetheless treated as a SSTB because of the skill and reputation of an owner or employee.

18.8.1.2 Services in Investing, Investment Management, Trading, or Dealing in Securities, Partnership Interests or Commodities

This second category of services included within the definition of SSTB is the performance of services in investing and investment management, trading, or dealing in securities, partnership interests or commodities.[175] Securities are those defined in Section 475(c)(2) and commodities are those defined in Section 475(e)(2).

One of the more vexing issues raised in this second category is its scope. What businesses are included within the meaning of a business of investing or investment management? Is a real estate developer that routinely invests his own money and services with money of third party investors in projects owned through a partnership performing investing and investment management services for the investors? The developer may be thought to be in the business of investing in or management of partnerships. But the partnership itself is also engaged in a trade or business of owning and operating the particular real estate project. At the partnership level, there is a trade or business that is not a SSTB. The Treasury might have concluded that field of service with respect to the QBI allocated to the real estate developer in our example is determined at the partnership level and not characterized differently at the partner/real estate developer level. If the rule were otherwise, the third party investors in the partnership owning the multi-family project may benefit from the Section 199A deduction, but the developer may not. A curious result. Happily, as explained below, the Proposed Regulations appear to have clarified the language of the statute. The Proposed Regulations separately define the terms of (i) "investing and Investment management," and "trading or dealing in securities…, partnership interests or commodities…."[176]

The Proposed Regulations provide that the performance of services that consist of investing and investment management refers to a trade or business involving the receipt of fees for providing investing, asset management, or investment management services including advising whether to buy or sell investments. None of which services appear to apply to the real estate developer in the example above. The Preamble provides that compensation for "investing and investment management" includes a commission, a flat fee or investment management fee determine as a percentage of assets under management. The Proposed Regulations provide that this field of service does not include directly managing real property.[177] As noted above, it is unclear whether this field could be partially subsumed under the fields of consulting or the field of

[174] *Id.*
[175] Section 199A(d)(2)(B); Prop. Reg. Section 1.199A-5(b)(xi).
[176] Prop. Reg. Section 1.199A-5(b)(xi).
[177] Prop. Reg. Section 1.199A-5(b)(2)(xi).

financial services. Also, note that the field of investment management is not delineated in Section 448 or Section 1202(e)(3)(A) but was specifically included in Section 199A(d)(2)(B).

The Proposed Regulations provide that the performance of services that consist of trading means a trade or business of trading in securities (as defined in Section 475(c)(2)), commodities (as defined in Section 475(e)(2)) or partnership interests. The determination is made based on all facts and circumstances including sources and types of profits regardless of whether the person trades for others or on his own account or a combination of both. However, trading activities incident to hedging is excluded, e.g. a farmer that hedges his crops.[178] The Preamble provides that factors considered relevant in determining whether a person is a trader include "source and type of profit generally sought from engaging in the activity regardless of whether the activity is being provided on behalf of a customer or for a taxpayer's own account." The Preamble cites the following cases for purposes of defining who is engaged in the trade or business of trading: Endicott v. Commissioner, T.C. Memo 2013-199; and Nelson v. Commissioner, T.C. Memo 2013-259.

Dealing in securities means regularly purchasing securities (within the meaning of Section 475(c)(2)) from and selling securities to customers in the ordinary course of a trade or business, or regularly offering to enter into, offset, assign or terminate positions for customers in the ordinary course of a trade or business.[179] Note that a taxpayer is not included within this category of trade or business simply by originating loans in the course of its business, as long as there is only negligible sales of loans.[180] Negligible sales is defined by referent to Treas. Reg. Section 1.475(c)-1(c)(2) and (4). Similar rules are provided for dealing in commodities.[181]

Dealing or trading in partnership interests means regularly purchasing partnership interests from and selling partnership interests to customers in the ordinary course of a trade or business, or regularly offering to enter into, offset, assign or terminate positions for customers in the ordinary course of a trade or business.[182] Note that this phrase narrows the statutory language of investing and trading or dealing in partnership interests. In that regard, one question raised by the statutory language is whether a taxpayer that is a real estate developer that routinely finances projects by offering partnership interests in partnerships that acquired, own and operate the project is somehow engaged in "trading or dealing in partnership interests." At least under the Proposed Regulations definition of "dealing in partnership interests" the developer should not be included under the situation describe above. There is simply no regular buying and selling to customers. Moreover, the real estate developer in this instance should not be included within the definition of investment management services within the meaning of Prop. Reg. Section 1.199A-5(b)(2)(xi). The developer is not receiving fees for its investing, asset management or investment management. Rather the developer receives a partnership interest through which the developer makes an investment of capital or services alongside investors. Moreover, the developer that separately receives a fee for project management would also seem to be excluded by the specific language of the regulations that excludes from investment management the direct management of real property.

18.8.1.3 *De Minimis* Exception

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178 Prop. Reg. Section 1.199A-5(b)(2)(xii).
179 Prop. Reg. Section 1.199A-5(b)(1)(xii).
180 Prop. Reg. Section 1.199A-5(b)(2)(xiii)(A).
181 Prop. Reg. Section 1.199A-5(b)(2)(xiii)(B)
182 Prop. Reg. Section 1.199A-5(b)(1)(xii)(C).

Because of the uncertainty as to what businesses will be swept up in the definition of the SSTB, there is a concern that a trade or business that would not otherwise be classified as a SSTB may nevertheless be treated as a SSTB if it performs ancillary services within one of the enumerated fields noted above. To address that concern, the Proposed Regulation provided a safe-harbor that prevents a trade or business from being classified as a SSTB simply because it performs a *de minimis* amount of one of the enumerated services.

This *de minimis* exception in the Proposed Regulations is not found in the Code. Under this rule, a trade or business is not classified as a SSTB if its gross receipts for the taxable year is no more than $25 million and less than 10% of the gross receipts are from one or more of the specified SSTB fields.[183]. If, however, the gross receipts from the one or more of the SSTB fields exceed 10%, Treasury officials have indicated that the trade or business will be classified as a SSTB. In that regard, the de minimis test acts as a cliff, one dollar of gross receipts more than the 10% amount will result in classification as a SSTB. For purpose of the 10% test, any activity incident to the actual performance of the service is considered performed in the field.[184] There is no explanation of what is intended to be picked up within the term “ancillary services.” To illustrate the point, consider a performing artist that has services associated with stage management or distribution rights of performances. While those latter services are not picked up as part of the field of performing arts could they be ancillary thereto for this de minimis test? If the trade or business's gross receipt is greater than $25 million for the taxable year, the exception is still available if less than 5% of its gross receipts are from one or more to the specified SSTB fields.[185]

18.8.1.4 Anti-Avoidance Rules

The Proposed Regulations provide anti-avoidance rules intended to prevent a SSTB from spinning-off certain of its assets into a new partnership whose operations would not otherwise be treated as a SSTB.[186] These are the so called "crack-and-pack" transactions.[187] One example of a crack-and-pack transaction would be a law firm that owns a building occupied by the firm for the practice of law. In order to take advantage of the Section 199A Deduction, the firm spins the building off into a new partnership owned by the firm’s partners and the law firm leases the building back. The new partnership is not a SSTB, and assuming it meets the definition of a trade or business, the individual owners would be entitled to a Section 199A Deduction.

The Preamble provides that the Treasury was concerned that taxpayers would try to separate out "parts of what otherwise would be an integrated SSTB, such as the administrative functions, in an attempt to qualify those separated parts for the section 199A deduction." Under the authority grated to the Treasury under Section 199A(f)(4), the Proposed Regulations provide rules to limit a taxpayer’s ability to separate out parts of an otherwise integrated SSTB

To that end, the Proposed Regulations provide that a SSTB is defined as one that includes any business that provides 80% or more of its property or services to a SSTB if there is more than 50% or more common ownership of the businesses.[188] Common ownership includes direct and indirect ownership by related parties within the meaning of Section 267(b) or Section 707(b).[189]

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[183] Prop. Reg. Section 1.199A-5(c)(1).
[184] Prop. Reg. Section 1.199A-5(c)(1)(i).
[185] Prop. Reg. Section 1.199A-5(c)(1)(ii).
[186] Prop. Reg. Section 1.199A-5(c)(2).
[187] Eric Yauch, “Crack-and-Pack Is Dead, but Law Firm Planning Isn’t, Tax Notes, September 27, 2018.
[188] Prop. Reg. Section 1.199A-5(c)(2)(i).
[189] Prop. Reg. Section 1.199A-5(c)(2)(iii).

What the rules does not specifically say but appears assumed is that one applies the constructive ownership rules of Section 267(c) for purposes of applying these rules. Moreover, if a trade or business provides less than 80% of the property or services to the commonly controlled entity, that portion of the business so provided to the common controlled entity is treated as part of the SSTB. Interesting questions may arise in those instances in which partnership with common ownership with an SSTB provide services or property not to the SSTB but instead provides services to a third party, e.g. collection work, offers-in-compromise with taxing authorities. While those activities might escape the prophylactic rules aimed at crack-and-pack, as discussed below there are another set of limiting rules where there is a sharing of expenses.

A trade or businesses that would not otherwise be classified as a SSTB will be so classified if: (i) the business and the SSTB have 50% or more common ownership (including with related parties within the meaning of Section 267(b) and 707(b)); (ii) the SSTB and other business share expenses such as overhead or shared wages; and (iii) the gross receipts of the business represent no more than 5% of the total combined businesses for the taxable year.[190] The Proposed Regulations under those facts conclude that the business is incidental to the business of the SSTB and therefore will be treated as part of the SSTB.[191] To illustrate this point, consider a medical practice operated through a partnership that owns its own building. Assume that the partnership only occupies 25% of the building and rents 75% of the space to unrelated third parties. The rental activity associated with the lease to third parties will be included within the SSTB if the rental activity produced less than 5% of the gross receipts of the combined gross receipts of both businesses and the businesses share expenses. Presumably, if the gross receipts of the rental activity exceeded the 5% test or there was no sharing of expenses the rental business would escape the SSTB taint.

The NYSB Tax Report addresses a concern about how the SSTB rules would work in tiered partnership structures. In that regard, that report pointed out the need to specifically address how to deal with tiered partnerships in which one was engaged in a SSTB and one was not. For example, assume upper-tier partnership is engaged in a SSTB and owns more than 50% of the interests in a lower-tier partnership engaged in a trade or business other than a SSTB. Does the fact that the partners of in the upper-tier partnership own their interest in the lower-tier partnership through a SSTB taint the lower-tier? As discussed below, the Proposed Regulations appear to address this fact pattern. In that instance, the fact that the lower-tier flows through the upper-tier would not cause the lower-tier partnership's business to be a SSTB as long as the lower-tier's gross receipts were more than 5% of the aggregate gross receipts of both partnership or there were no sharing of common expenses. This also assume the lower-tier did not provide 80% or more of its property or services to the upper-tier partnership.

18.8.2 Trade or Business of Performing Services as an Employee

A trade or business does not qualify for the Section 199A Deduction if it is the trade or business of performing services as an employee.[192] The Proposed Regulations provide that the term "trade or business" for purposes of Section 199A does not include performing services as an employee.[193] To that end, wages will never qualify as QBI. The Preamble notes that the status as employee is determined under common law statutory rules, and guidance in determining

[190] Prop. Reg. Section 1.199A-5(c)(3)(i).
[191] *Id.*
[192] Section 199A(d)(1)(B); Prop. Reg. Section 1.199A-5(d).
[193] Prop. Reg. Section 1.199A-5(d)(1).

employee status is found in Treas. Reg. Sections 31.3121(d)-1, 31.3306(i)-1 and 31.3401(c)-1.[194] Income from providing services as an employee include wages (within the meaning of Section 3401(a)), and other income earned in the capacity as an employee including payments under Treas. Reg. Section 1.6041-2(a)(1)(other than payments to individuals described in Section 3121(d)(3) and Treas. Reg. Section 1.6041-2(b)(1).[195] The Preamble states that income that is not derived from a trade or business described within those sections and the Treasury Regulation cited is not considered to be in the business of performing services an employee.

18.8.2.1 Misclassified Employees

Whether the employer treats the employee as anything other than an employee for Federal employment tax purposes is irrelevant to the determination that person's treatment under Section 199A.[196] And if the employer improperly treats the employee as an "independent contractor or other non-employee," such person will be treated as an employee regardless of the employer's misclassification.[197]

18.8.2.2 Officers as Employees

The Preamble references that under Section 3401(c) generally an officer of a corporation (including an S corporation) will be an employee of that corporation. But, the Preamble notes that an officer will not be treated as employee if the services performed by the officer in his or her capacity as such are minor and the officer does not receive, and is not entitled to receive, any compensation from the corporation. Factors to be considered in making the determination of whether the services of the officer are minor include the nature of the services, the frequency and duration of performance and the actual and potential importance or necessity of the services in question in relation to the corporation's business. As an example, see Rev. Rul. 74-390, 1974-2 CB 331.

18.8.2.3. Anti-Avoidance Rule

The Preamble noted that the Treasury was concerned about taxpayers that attempt to benefit from a Section 199A Deduction by classifying employees as independent contracts or giving the employees equity ownership in a partnership or S corporation.[198] The Treasury's concern was that a SSTB operating as partnership might try and convert employees to partners or attempt to restructure employment arrangements an independent contractors. In that regard, the Proposed Regulations create a presumption that an individual that was treated as an employee for federal employment tax purposes by a person and who thereafter is treated as other than employee by that person but continues to provide substantially the same services (directly or indirectly) to the person (or a related person thereto) will be presumed to be in the trade or business of performing services as an employee.[199] The presumption applies regardless of whether the individual provides the services directly or through an entity or entities.[200] The presumption is rebuttable if the individual can show that under applicable federal tax rule (including common-law classification rules) that the individual is performing the services other

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[194] *Id.*
[195] *Id.*
[196] Prop. Reg. Section 1.199A-5(d)(2).
[197] Prop. Reg. Section 1.199A-5(d)(2).
[198] See Eric Yauch, "Crack-and-Pack Is Dead, But Law Firm Planning Isn't," Tax Notes, September 27, 2018.
[199] Prop. Reg. Section 1.199A-5(d)(3).
[200] *Id.*

than as an employee.[201] Note that the classification of the person under Section 199A does not change the persons classification for other purposes of the Code.

18.8.3 Effective Dates

The rules provided in Proposed Regulations apply to taxable years ending after the date the Treasury adopts these regulations as final regulations published in the Federal Register. However, taxpayers may rely on the rules until the Treasury adopts these regulations as final regulations. One big caveat is that the following rules apply to taxable years beginning after December 22, 2017: (i) in Prop. Reg. Section 1.199A-5(c)(2)(anti-abuse rules applicable to so called "crack and pack" reorganizations); (ii) Prop. Reg. Section 1.199A-5(c)(3)(anti-abuse rules applicable to commonly owned entities of which one is a SSTB and another performs ancillary services to the SSTB); and (iii) Prop. Reg. Section 1.199A-5(d)(3)(anti-abuse rule creating presumption of employee status).

18.9 Cap For Section 199A Deduction

For individual's with taxable income for the year equal to or greater than the Threshold Amount, the Section 199A Deductions cannot exceed the applicable Cap, which is an amount equal to the greater of (i) 50% of the W-2 wages for the trade or business or (ii) 25% of the W-2 wages for the trade or business plus 2.5% of the UBIA of qualified property for the trade or business.[202] As discussed in Paragraph 18.5.2.2.2, the Caps are adjusted for individuals with taxable income within the Phase-In Range.

The Section 199A and the Proposed Regulations provide rules for calculating the Cap.[203]

18.9.1 W-2 Wages

The W-2 wages must be determined for each trade or business.[204] If the business is conducted by the individual as a sole proprietorship, the individual makes the determination. If the business is conducted through an RPE, the entity conducting the business must make the determination.[205] The Preamble states that the rules under the Proposed Regulations regarding W-2 wages are patterned after Section 199.

18.9.1.1 W-2 Wages Allocable to QBI

Section 199A(b)(4)(B) provides that W-2 wages are included in the calculation of the Cap only if the wages are paid with respect to a trade or business and properly allocable to the QBI of that trade or business. The Proposed Regulations provide a three-step process for determining the W-2 wages paid with respect to a trade or business that are properly allocable to QBI for such business.[206]

18.9.1.1.1 First Step

[201] *Id.*
[202] Section 199A(b)(2).
[203] Section 199A(b)(4)-(6); Prop. Reg. Section 1.199A-2.
[204] Prop. Reg. Section 1.199A-2(a)(2).
[205] *Id.*
[206] Prop. Reg. Section 1.199A-2(b)(1).

The first step is to determine the W-2 wages paid for the taxable year by the individual or RPE conducting the trade or business. Except for short taxable years, wages paid for this purpose are wages reported on the Forms W-2 "Wage and Tax Statement" for the calendar year ending during the taxable year.[207]

18.9.1.1.1.1 Calendar Year Requirement

Generally, the W-2 wages includible in applying the Cap for the individual's or PRE's taxable year are the wages paid during the calendar year ending within or with that taxable year.[208] In the case of a short taxable year that does not include a calendar year end, the W-2 wages for purposes of the Cap are those wages paid during the short year provided that the wages otherwise meet the requirements of Section 199A.[209] For example, assume partnership A has a June 30 fiscal year end, and A liquidates on October 31, 2019. In that case, A's taxable year from July 1, 2019 through October 31, 2019, does have a calendar year end within that short year. But under the short year rule, A would compute the Cap for the short year by including W-2 wages paid during the short year.

In the case of a short year that does include a calendar year end, the analysis is more complicated and it is unclear how the rules work. The Proposed Regulations provide that in computing the Cap only W-2 wages paid in the short year count.[210] To illustrate the conundrum, assume partnership A has a June 30 fiscal year. Assume that A commences business July 1, 2018 and operates for a full 12 months ended June 30, 2019. For the first taxable year, A's Cap would be treated as including only the W-2 wages included in the calendar year end December 31, 2018, and would excluded the wages paid form January 1, 2019 to June 30, 2019. Assume A operates for an additional full 12 months (i.e., from July 1, 2019 to June 30, 2020). In that case in computing the Cap for the year end June 30, 2020, the W-2 wages would be those paid for the year ended December 31, 2019, which is a full 12 months from January 1, 2019 to December 31, 2019. Now assume that A liquidates on March 1, 2021. In that case A has a short taxable year which includes the calendar year end December 31, 2020. The Proposed Regulations require that the W-2 wages for the short year include only wages paid during that short year, in which case only the wages from July 1, 2020 through March 2, 2021 would count. In other words, the calendar year rule appears not to apply, and if so, what is missing is that the wages paid from January 2, 2020 through June 30, 2020 are never counted in the Cap for any taxable year.

18.9.1.1.1.2 Wages Defined

For this purpose, W-2 wages include the amounts described in Section 6051(a)(3) and (8) paid by any person with respect to employment of employees during the calendar year ending within the taxable year as defined in Section 3401(a), plus amounts of elective deferrals (within the meaning of Section 402(g)), deferral under Section 457 and amounts designated as ROTH contributions (as defined in Section 402A).[211] Section 199A(b)(4)(C) and the Proposed Regulations provide specific rules to the effect that W-2 wages to be included in the Cap must be included in returns filed with the Social Security Administration on or before the 60th day after the due date (with extensions) for such return.[212] Returns filed with the Social Security Administration

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[207] Prop. Reg. Section 1.199A-2(b)(2)(i).
[208] *Id.*
[209] Prop. Reg. Section 1.199A-2(b)(2)(iv)(C)(2).
[210] Prop. Reg. Section 1.199A-2(b)(2)(iv)(C)(1).
[211] Prop. Reg. Section 1.199A-2(b)(2).
[212] Prop. Reg. Section 1.199A-2(b)(2)(iii)(A).

for this purpose includes Form W-2 and the transmittal for W-3.[213] Rules are also provided for correction of such returns.[214] As a reporting matter, except in the case of short taxable years, this means that the wages paid are those reported on IRS "Forms W-2 Wages, Wage and Tax Statement" issued for the calendar year ending during the individual's or RPE's taxable year.

The Proposed Regulations address cases in which an employer pays common law employees through third parties.[215] W-2 wages paid by an organization such as a certified professional employer organization to common law employees or officers of an individual's or RPE's trade or business may be taken into account by the individual or RPE in computing its Cap. Even though a payroll organization may claim the wages on its Form W-2 as the employer, the wages may nonetheless be reported as wages paid by a trade or business if the W-2 wages are paid to a common law employees or officers on behalf of the trade or business. The Proposed Regulations provide what appears to be an non-exclusive list of such arrangements in which persons report W-2 wages on behalf of others: certified professional employer organizations under Section 7705, statutory employers under Section 3401(d) and agents under Section 3504.[216] In these instances even though the agent under Section 3504 files the W-2 reporting on wages and is listed as the employer, the common law employer may still take the W-2 wages into account in computing the Section 199A Deduction. See the Preamble for an explanation of how the Section 199A rules are modeled after the Section 199 rules. In all cases, the payroll service is precluded from claiming the W-2 wages in computing its own Section 199A Deduction.[217]

Notice 2018-64, 2018-34 IRB 347 provides that a taxpayer must use one of three methods for calculating W-2 wages. The taxpayer must follow one of these three methods in determining the amount the of W-2 wages to be allocated.

The Proposed Regulations provide rules for computing the Cap when a trade or business (or major portion thereof) is acquired or disposed of in an incorporation, a formation, a liquidation, a reorganization, or a purchase or sale of assets. In those instances, there will be two employers during the calendar year, and the W-2 wages must be allocated between the multiple employers based on the period during which employees of the acquired or disposed of business were employed by the respective employer.[218] This treatment follows regardless of whether the predecessor and successor employers agree to use the procedure permitted by Rev. Proc. 2004-53, 2004-34 IRB 320, by which the successor employer assumes the predecessor's entire Form W-2 reporting obligation for the acquired employees.[219] Note that Notice 2008-64, 2018-34 IRB 347, provides that the W-2 wages must be determined using the so called "tracking method" explained in the Notice.

18.9.1.1.2 Second Step

The second step in the Proposed Regulation's three-step process for determining the W-2 wages applicable to the Cap is to allocate the W-2 wages paid among multiple trades or businesses conducted directly by the individual or indirectly through an RPE.[220] W-2 wages must

[213] *Id.*
[214] Prop. Reg. Section 1.199A-2(b)(2)(iii).
[215] Prop. Reg. Section 1.199A-2(b)(2)(ii).
[216] Prop. Reg. Section 1.199A-2(b)(2)(ii).
[217] Prop. Reg. Section 1.199A-2(a)(1)(ii).
[218] Prop. Reg. Section 1.199A-2(b)(2)(iv).
[219] *Id.*
[220] Section 199A(b)(4); Prop. Reg. Section 1.199A-2(b)(3).

be allocated to the trade or businesses that generated those wages in the same manner as the deductions associated with the wages are allocated among the businesses.[221] In that regard, the taxpayer may use any reasonable method based on all of the facts and circumstances, consistently applied from year to year.[222] If an individual or RPE with multiple trades or businesses properly elects to aggregate the trades or businesses under the Proposed Regulations, the W-2 wages for such aggregated businesses will be combined in computing the Cap.[223]

18.9.1.1.3 Third Step

The third step in the Proposed Regulation's three-step process is to properly allocate the W-2 wages to QBI for each such business.[224] For this purpose, W-2 wages are properly allocable to QBI if the wage deduction is properly taken into account in computing QBI under Prop. Reg. Section 1.199A-3. Note that under the Proposed Regulations the partnership or S corporation is responsible for reporting the W-2 wages allocable to its partners or shareholders.[225]

18.9.1.2 Allocations of W-2 Wages by an RPE to Its Owners

If a partnership or S corporation operates the trade or business and pays the wages, the partners or shareholders must know their allocable share of the W-2 wages paid by entity. Section 199A(f)(1)(A) provides that W-2 wages are allocated among partners and shareholders of S corporations in the same manner as they share the wage expense. In that regard, for partnerships the allocation should follow the rules of Section 704(b) for purposes of determining a partner's distributive share of wage expense. Generally, the allocation to a partner of the partnership's bottom line taxable income is treated as an allocation to such partner of the same share of each item of income, gain, loss and deduction taken into account in computing the bottom line.[226] For an S corporation shareholder, the allocation would be in proportion to the shareholder's stock ownership in the corporation.

18.9.1.3 Effective Date

The rules for W-2 wages apply to taxable years beginning after the date the Treasury adopts final regulations by publication in the Federal Register. However, taxpayer may rely on the rues until the final regulations are published.[227]

18.9.2 UBIA of Qualified Property

The UBIA for qualified property with respect to a trade or business conducted by an individual or RPE must be determined in order to compute the Cap. The Proposed Regulations provide the manner in which this determination is made.[228]

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[221] Prop. Reg. Section 1.199A-2(b)(3).
[222] Prop. Reg. Section 1.199A-2(b)(3); and Prop. Reg. Section 1.199A-3(b)(5).
[223] Prop. Reg. Section 1.199A-1(d)(2)(ii).
[224] Prop. Reg. Section 1.199A-3(b)(4).
[225] . Prop. Reg. Section 1.199A-2(b)(4).
[226] Treas. Reg. Section 1.704-1(b)(1)((vii).
[227] Prop. Reg. Section 1.199A-2(d).
[228] Prop. Reg. Section 1.199A-2(c).

18.9.2.1 Qualified Property Defined

The term "qualified property" means for any trade or businesses, tangible property of a character subject to depreciation under Section 167(a) that satisfies the following conditions: (i) the property is held by, and available for use in, the business as the close of the taxable year; (ii). the property is used at any point during the taxable year in the business's production of QBI; and (iii) the depreciable period (as defined below) has not ended before the taxable year of the individual, partnership or S corporation, as applicable.[229]

18.9.2.2 UBIA Defined

Under the Proposed Regulations, the UBIA is the amount of basis on the placed in service date of qualified property as determined under Section 1012 or other applicable sections of Chapter 1, including SubChapter O (relating to gain or loss on disposition), SubChapter C (relating to corporate distributions and adjustments) and SubChapter K (relating to partners and partnerships).[230] (The Preamble indicates that these rules were modeled on Treas. Reg. Section 1.263(a)-3(h)(5)).

18.9.2.2.1 UBIA Not Adjusted for Depreciation or Amortization

UBIA is not adjusted by reason of depreciation and amortization under Section 1016(a)(2) or (3), or tax credits under Section 50(c) or reduced for any election to treat any portion of the basis as an expense under Sections 179, 179B or 179C. *Id*. Additionally, UBIA is not reduced by additional first year depreciation. Therefore the UBIA of purchase or produced property will generally be its cost as determined under Section 1012 at the time the property is first placed in service. However, note the rules discussed below applicable to the determination of UBIA for qualified property contributed by a partner to a partnership or by a shareholder to an S corporation.

18.9.2.2.2 Basis Adjustments under Section 734(b) or Section 743

Basis adjustments under Section 743(b) or Section 734(b) are not treated as qualified property.[231]

18.8.2.2.3 Additions to Basis

Any additions to basis of qualified property subsequent to the period the original property was placed in service is treated as separate qualified property first placed in service on the date such addition is place in service under Prop. Reg. Section 1.199A-2(c)(2.[232] The Preamble provides the following example: assume taxpayer purchased and placed in service equipment on March 26, 2018, and then on May 2020 makes capital expenditures to improve the equipment. The Preamble concludes that the taxpayer has two qualified properties each with a different placed in service date, the first place in service date is March 26, 2018, the date the equipment was purchased and place in service and the second placed in service date is May 2020, the date the improvements were placed in service.

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229 Section 199A(b)(6)(A); Prop. Reg. Section 1.199A-2(c)(1).
230 Prop. Reg. Section 1.199A-2(c)(3).
231 Prop. Reg. Section 1.199A-2(c)(1)(iii)
232 Prop. Reg. Section 1.199A-2(c)(1)(ii).

18.9.2.3 UBIA for Qualified Property Transferred in Non-Recognition Transactions

As noted above, the Proposed Regulations provide that UBIA of qualified property on the placed in service date of such property as determined under Section 1012 or other applicable sections of Chapter 1, including SubChapter O (relating to gain or loss on disposition), SubChapter C (relating to corporate distributions and adjustments) and SubChapters K (relating to partners and partnerships).[233] The Preamble indicates that these rules were modeled on Treas. Reg. Section 1.263(a)-3(h)(5).

The reference to SubChapter K means that, when otherwise qualified property is contributed by a partner to a partnership in a transaction described in Section 721, the partnership's UBIA with respect to the property is the partner's current tax basis in the property as determined under Section 723, i.e., it is not the partner's historic cost basis but rather the partner's basis reduced by prior depreciation. Similarly, when a shareholder contributes property to an S corporation, the S corporation's UBIA with respect to the property is the basis of the S corporation in the property as determined under Section 362. In other words, the UBIA of a partnership that receives a contribution of qualified property in a transaction described in Section 721 will not be the partner's UBIA but rather will be the depreciable basis of that property at the time of the contribution. Planning opportunities should be considered to avoid the step down in UBIA in the situation described above. For example, assume upper-tier partnership A owns qualified property with a UBIA of $100 and a depreciable basis of $10, and individual B approaches A about forming a new partnership in which B will be a partner. If A simply contributes the qualified property to a lower-tier partnership with B, then the UBIA for all partners will be $10. On the other hand, if the A simply admits B to the upper-tier partnership, there is no step-down in the UBIA of the qualified property.

18.9.2.4 Anti-Avoidance Rules

The Proposed Regulations under its authority provided in Section 199(f)(4) include rules to prevent taxpayers from manipulating the UBIA of qualified property. The rules are designed, part , to prevent a trade or business from acquiring qualified property shortly before year end and then disposing of the property shortly thereafter. To that end, the Proposed Regulations provide that if property is acquired within 45 days of the close of the taxable year and disposed of within 120 days without having been used in the business for at least 45 days, the property will not be treated as qualified property unless the taxpayer demonstrates that the principal purpose of the acquisition was not to increase the Section 199A Deduction.[234]

18.9.3. Depreciable Period Defined

The term "depreciable period" means with respect to qualified property, the period beginning on the date the property was first placed in service and ending on the later of: (i) 10 years after such date; or (ii) the last day of the last full year in the applicable recovery period under Section 168(c) without regard to Section 168(g)(i.e., property subject to the alternative depreciation method).[235]

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[233] Prop. Reg. Section 1.199A-2(c)(3).

[234] Prop. Reg. Section 1.199A-2(c)(1)(iv).

[235] Section 199A(b)(6)(B); Prop. Reg. Section 1.199A-2(c)(2).

18.9.3.1 Additional Depreciation

Importantly, the Proposed Regulations provide that additional first-year depreciation allowable under Section 168 (including Section 168(k) or (m)) will not impact the applicable recovery period under Section 186(c) for qualified property. For example, an individual that acquires tangible depreciable property in 2018 for a purchase price of $100 and takes depreciation in 2018 under Section 168(k) of $100 will nonetheless have UBIA for that qualified property of $100 with a recovery period determined under Section 168 (c) without regard to the bonus depreciation.[236]

18.9.3.2 Non-Recognition Transfers of Qualified Property

The Proposed Regulations provide special rules in connection with the acquisition of qualified property by a partnership or corporation in a non-recognition transfer under Section 721, Section 351, or Section 361 (as the case may be), or by an individual in connection with the distribution from a partnership in a non-recognition distribution under Section 731. Prop. Reg. Section 1.199A-2(c)(2(iv). In those instances, the transferee (either the individual, partnership or S corporation, as the case may be) must determine the date the property was first placed in service as follows: (i) the date the property was first placed in service by the transferor must be used by the transferee with respect to the transferee's unadjusted basis in the property as that does not exceed the transferor's unadjusted basis; and (ii) any unadjusted tax basis of the transferee in the property in excess of the carryover tax basis is treated as separate qualified property first placed in service on the date of the transfer. What this means in the context of a contribution by a partner to a partnership under Section 721 is that: (i) the partnership uses the partner's placed in service date for determining the partnership's depreciable period to the extent the partnership's unadjusted basis does not exceed the partner's unadjusted basis; and (ii) for the portion of the partnership's unadjusted basis that exceeds the partner's unadjusted basis, such portion is treated as separate qualified property first placed in service on the date of the transfer. See Preamble; Prop. Reg. Section 1.199A-2(c)(4), Example 3.

The Proposed Regulations appear to take different approaches in determining the beginning of the depreciable period and the UBIA of qualified property transferred in a non-recognition event. For example, assume in 2018 a partner contributes property A to a partnership in a transaction described in Section 721. Assume that the partner has a UBIA in the property of $100, a tax basis of $10 and that the property first placed the property in service in 2017. In that case, under Section 723, the partnership takes a tax basis of $10 in the property which is equal to the contributing partner's tax basis. The partnership's UBIA will be $10 and the depreciable period starts in 2017, the date property was first placed in service by the partner.

18.9.4 Section 1031 Like Kind Exchanges

The Proposed Regulations provide special rules in connection with the acquisition of qualified property in a transaction subject to Section 1031 or Section 1034.[237]

18.9.5 Partnerships and S Corporations

An individual, or RPE that owns qualified property must determine UBIA for each trade or business without regard to whether the businesses are aggregated under the aggregation rules

[236] Prop. Reg. Section 1.199A-2(c)(2)(ii).
[237] Prop. Reg. Section 1.199A-2(c)(2)(iii).

in Prop. Reg. Section 1.199A-4. In the case of a partnership or S corporation, the partner's or shareholder's share of the UBIA is that amount which bears the ratio to the total UBIA as the partner's or shareholder's share of depreciation for that property bears to the total depreciation for the property for the year.[238] The allocation of depreciation should be made following the general allocation rules of Section 704(b) and Section 704(c). Generally, the allocation to a partner of the partnership's bottom line taxable income is treated as an allocation to such partner of the same share of each item of income, gain, loss and deduction taken into account in computing the bottom line.[239]

As noted above, the Proposed Regulations provide that an adjustment under Section 734(b) or Section 743(b) will not either increase or decrease the UBIA of qualified property for which the adjustment is made. However, a partner with a positive Section 734(b) or Section 743(b) adjustment in property is entitled to calculate that partner's depreciation with respect to the property by taking the adjustment into account.[240] In other words, the partner with a Section 743(b) adjustment gets more deprecation if the adjustment is positive and less if the adjustment is negative. The Proposed Regulation do not specifically provide how these items should count in determining a partner's share of UBIA for purposes of the Section 199A Deduction.

In the case of a partnership in a year in which the qualified property had no depreciation for the year, e.g., in a year subsequent to the year in which it elected the first-year additional depreciation (100%), each partner's share of the UBIA is based on how the gain would be allocated to the partner under Section 704(b) and Section 704(c) if the property was sold for cash at its fair market value. In that same example but in which the owner is an S corporation, the UBIA of the S corporation is shared among the shareholders in proportion to their share ownership. Note if the partnership or S corporation fails to provide the UBIA information to the partner or owner, the UBIA for any qualified property of the entity is presumed to be zero.[241]

18.9.6 Effective Date

The rules for UBIA apply to taxable years beginning after the date the Treasury adopts final regulations by publication in the Federal Register. However, taxpayers may rely on the rues until the final regulations are published.[242]

18.10 Reporting Under Section 199A for PREs and PTPs

Neither an RPE nor a PTP is entitled to a Section 199 Deduction. Instead, an RPE and PTP must report the information necessary for its direct and indirect owners to calculate the Section 199A Deduction. Each RPE and PTP is responsible under the Proposed Regulations with providing necessary information to its owners to permit the owners to calculate their Section 199A Deduction. Prop. Reg. Section 1.199A-6.

18.10.1 Computational and Reporting Rules for RPEs

18.10.1.1 Computational Steps

[238] Prop. Reg. Section 1.199A-2(a)(3).
[239] Treas. Reg. Section 1.704-1(b)(1)((vii).
[240] Treas. Reg. Section 1.743-1(j)(2).
[241] Prop. Reg. Section 1.199A-2(a)(3).
[242] Prop. Reg. Section 1.199A-2(d).

The RPE must compute QBI in the following manner:

(i) First, the RPE identifies the number of trades or businesses in which it is directly engaged.[243]

(ii) Second, the RPE must identify whether any of such trades or businesses are a SSTB.[244]

(iii) Third, the QBI for each trade or business must be determined under Prop. Reg. Section 1.199A-3.[245]

(iv) Fourth, the W-2 wages and UBIA for each trade or business must be determined under Prop. Reg. Section 1.199A-2.[246]

(v) Fifth, the RPE must determine any directly received qualified REIT dividends (within Prop. Reg. Section 1.199A-3(c)(1) or qualified PTP income (within Prop. Reg. Section 1.199A-3(c)(2).

18.10.1.2 Reporting Steps

The RPE must to separately identify and repot on each owner's K-1 the items listed below.[247] Note that this information must be provided regardless of whether an owner is below the Threshold Amount.

(i) Each owner's share of W-2 wages, UBIA, and QBI for each trade or business.[248]

(ii) Identify any SSTB.[249]

(iii) The RPE must provide all of the information in (i) and (ii) above on a K-1 for the owner with respect to any RPE in which it is a direct or indirect owner.

If the RPE fails to comply with the foregoing reporting and computational responsibilities, the owners positive QBI, W-2 wages and UBIA from the RPE is presumed to be zero. **Practice Point: the reporting rules put the responsibility for compliance with Section 199A squarely on the RPE. Failure of the RPE to administer the computational and reporting rules will likely significantly impede the owners ability to take the Section 199A Deduction.**

18.10.2 Computational and Reporting Rules for PTPs

The Proposed Regulations impose computational and reporting rules on PTPs that allow their owners to calculate the owners' Section 199A Deduction.[250]

[243] Prop. Reg. Section 1.199A-6(b)(2)(i).
[244] Prop. Reg. Section 1.199A-6(b)(2)(i).
[245] Prop. Reg. Section 1.199A-6(b)(2)(ii).
[246] Prop. Reg. Section 1.199A-6(b)(2)(iii).
[247] Prop. Reg. Section 1.199A-6(b)(3)(i).
[248] Prop. Reg. Section 1.199A-6(b)(3)(i)(A).
[249] Prop. Reg. Section 1.199A-6(b)(3)(i)(B).
[250] Prop. Reg. Section 1.199A-6(c).

18.10.2.1 Computation Rules

A PTP must determine its QBI as computed under Prop. Reg. Section 1.199A-3 for each trade or business it directly engages in, and whether any such business is a SSTB.[251]

18.10.2.2 Reporting Rules

The PTP must report on each owner's K-1 such owner's share of the QBI for each trade or business as well as any qualified REIT dividend or qualified PTP income or loss through another RPE, REIT, or PTP.[252] Note that a PTP is not required to determine and report W-2 wages or UBIA of qualified property because it is irrelevant to the partner's Section 199A Deduction with respect to qualified PTP income.[253]

[251] Prop. Reg. Section 1.199A-6(c)(1).
[252] Prop. Reg. Section 1.199A-6(c)(2).
[253] *Id.*

Appendix A.18.11

Examples Contained In Proposed Regulations

A.18.11.1 Proposed Regulations: 1.199A-1(c)(3) Examples Illustrating Computation of Section 199A Deduction When Taxable Income Is Less than or Equal to the Threshold Amount

For purposes of these examples, assume that all of the trades or businesses are trades or businesses within the meaning of that term under the Prop. Reg. Section 1.199A-1(b)(13) and none are SSTBs as defined under Prop. Reg. Section 1.199A-1(b)(10) and Section 1.199A-5(b). Assume further that all items otherwise qualify as QBI and total taxable income is determined without regard to the 199A deduction.

Example 1: Computation of Section 199A Deduction Determined With Reference to Taxable Income Limitation

Facts: A files as an unmarried taxpayer. A operates a sole proprietorship that had QBI in 2018 of $100,000. A's total taxable income in 2018 determined without regard to items of deduction in computing QBI of $81,000. Analysis: Section 199A Deduction: A is below the Threshold Amount so that the Section 199A Deduction is determined without regard to the Cap. Accordingly, A's Section 199A Deduction for 2018 is simply 20% of the QBI of $100,000, or $20,000. That amount exceeds the 20% of taxable income limitation $16,200, and therefore, A's Section 199A Deduction is limited to $16,200. Highlight: The example illustrates that the Section 199A Deduction cannot exceed 20% of the taxpayer's taxable income for the year.

Example 2: Taxable Income Reduced by Net Capital Gains

Facts: Assume the same facts as Example 1 except that A's taxable income in 2018 determined without regard to items of deduction included in QBI is $74,000, and includes $7,000 of net capital gain. Analysis: In that case, because the QBI is the same, before the application of the taxable income limitation, the Section 199A Deduction would be $20,000 (i.e., 20% of $100,00). However, the 20% limitation of taxable income must be computed by reducing the taxable income of $74,000 by the $7,000 of net capital gain, or $67,000. Thus, the Section 199A Deduction is limited to 20% of $67,000 (taxable income less net capital gain), or $13,400. Highlight: The example illustrates that in computing the limitation based on 20% of taxable income, the taxpayer's taxable income must be reduced by net capital gains.

Example 3: Caps Not Relevant to Individuals with Taxable Income at or Below Threshold Amount/Wages Paid by Trade or Business to Owner Not Included in QBI

Facts: B and C file a joint return. For 2018: (I) B earned wages from a third party of $500,000; (II) C owns all of an S corporation engaged in a trade or business that generated $100,000 of QBI and paid C wages of $150,000; (III) B and C have taxable income of $270,000 without regard to items of deduction in computing QBI. QBI does not include wages paid to either B or C. Analysis: Section 199A Deduction: B and C are below the taxable income Threshold Amount [$315,000 for married filing jointly)), and accordingly, the Section 199A Deduction is computed without regard to the limitation of the Caps. Thus, the Section 199A Deduction is 20% of the QBI of $100,000, or $20,000. The taxable income limitation is not applicable because 20% of the QBI,

$20,000 (20% of $100,000), does not exceed the 20% of taxable income limitation (in this case, 20% of $270,000, or $54,000). The Section 199A Deduction is $20,000 for 2018. Highlight**:** Wages paid by S corporation to shareholder are not included in the shareholder's QBI with respect to the trade or business conducted by the S corporation. Caps not applicable for taxpayer below Threshold Amount.

Example 4: Taxable Income Limitation With Qualified PTP Income and Qualified REIT Dividends

Facts: Assume the same facts as Example 3 except B and C also earns $1,000 of qualified REIT dividends and $500 from a qualified publicly traded partnership. The taxable income for 2018 is $271,500 ($270,000 plus the REIT dividend of $1,000 plus $500 from their share of publicly traded partnership income). Analysis: Section 199A Deduction: The Section 199A Deduction is equal to $20,000 for the QBI from the S corporation plus 20% of qualified REIT dividend (20% of 1,000, or $200) and qualified publicly traded partnership (20% of $500, or $100), for a total of $20,300. The Section 199A Deduction is not limited by the 20% of taxable income limitation (20% of $271,500, or $53,300). Highlight: Illustrates application to Section 199A Deduction with respect to qualified PTP income and qualified REIT dividends.

A.18.11.2 Proposed Regulations: 1.199A-1(d)(4) Examples Illustrating Computation of Section 199A Deduction When Taxable Income Greater than Threshold Amount

For purposes of these examples, assume that all of the trades or businesses are trades or businesses within the meaning of that term under the Prop. Reg. Section 1.199A-1(b)(13) and unless otherwise stated none are SSTBs as defined under Prop. Reg. Section 1.199A-1(b)(10) and Section 1.199A-5(b). Assume further that all items otherwise qualify as QBI, there are no net capital gains and total taxable income is determined without regard to the Section 199A Deduction.

Example 1: QBI Component Limited by Cap

Facts: D is unmarried with QBI of $1,000,000 from leasing multiple parcels of land for use by an airport as parking lots. D’s taxable income determined after including deductions unrelated to the business is $980,000.[254] No wages are paid by the business and no qualified property is used, in connection with the business. Analysis: D's QBI Component is zero (the lesser of (i) 20% QBI, or $200,000 (20% multiplied by $1,000,000) or (ii) the Cap, which in this case is zero because the business had no W-2 wages or UBIA of qualified property). Highlight:. If the individual's taxable income is above the Threshold Amount plus $50,000 ($100,000 for joint filers), the QBI Component is not simply 20% of the individual’s QBI, but rather is the lesser of the 20% of the QBI or the Cap. And in this instance, if the individual's Cap is zero, no Section 199A deduction is available.

Example 2: QBI Component Limited by Cap

Facts: Same as Example 1 except that in 2019 D built parking garages on the parcels at a cost of $10 million, all of which is depreciable. D in 2020 earned QBI of $4 million for leasing the

[254] The language in the Proposed Regulations is confusing when it refers to taxable deduction determined after taken into account deduction unrelated to the business. In this example, what the Proposed Regulations’ intend is that D would have taxable income of $1,000,000 (all of which under the facts consisted of QBI) and that after taking into account items such as itemized deductions the taxable income is $980,000.

garages and land to the airport. D's total taxable income in 2020, after deduction unrelated to the related to the trade or business, is $3,980,000. Analysis: D's taxable income is above the threshold amount and is therefore subject to the limitation for the Cap. D's trade or business has no W-2 wages but does have qualified property with an UBIA of $10 million, and as a result, the applicable Cap is $250,000 (i.e., 2.5% multiplied by $10 million of UBIA). D's QBI Component is $250,000 (i.e., the lesser of (i) 20% of $4 million, or $800,000, or (ii) 2.5% of $10 million, or $250,000). The taxable income limitation is not applicable because D's QBI Component of $250,000 is less than $790,000 (20% multiplied by D's taxable income of $3,980,000). Highlight: The QBI Component may be limited by the Cap. The UBIA of qualified property increases the Cap. The Section 199A Deduction is not always simply the QBI Component; rather the Secton 199A Deduction cannot exceed 20% of the taxpayer's taxable income for the year (as determined without regard to the items included in determining QBI). It is worth emphasizing that Section 199A(e)(1) provides that taxable income as used in Section 199A is determined without regard to the Section 199A deduction.

Example 3: Trade or Business Operated Through Partnership and Individual's Section 199A Deduction Determined by Reference to Individual's Share of QBI, W-2 Wages and UBIA of Qualified Property from Partnership

Facts: E is unmarried and owns a 30% membership interest in an LLC taxed as a partnership. In 2018, the LLC had one trade or business that reported QBI of $3 million, W-2 wages of $1 million and $100,000 of UBIA in qualified property. E's share of QBI, W-2 wages and UBIA, is as follows:

QBI	$900,000	
W-2 Wages	$300,000	
UBIA	$30,000	

E had taxable income for 2018 computed after deductions unrelated to the trade or business of $880,000. E's taxable income is above the threshold amount so that the Cap applies in computing the QBI Component. Analysis: The 20% Component is equal to $180,000 (20% multiplied by E's QBI of $900,000). However, in this case, QBI Component is limited by the Cap. The Cap is $150,000 calculated as follows; the greater of: (i) 50% of the E's allocable share of the W-2 wages of $300,00, or $150,000; and (ii) the sum of 25% of W's allocable share of the W-2 wages, or $75,000; plus 2.5% of W's allocable share of the UBIA of qualified property, or $750. Thus E's QBI Component for 2018 is $150,000. The Section 199A Deduction is not subject to the taxable income limitation because the QBI Component of $150,000 is less than 20% of the taxable income of $880,000, or $178,000. Highlight: The individual's QBI Component includes his distributable share of the QBI allocated by a partnership engaged in a trade or business. To determine the Cap, the individual must determine the individual's allocable share of the partnerships' W-2 wages and UBIA of qualified property. W-2 wages were allocated among the partners in the same manner as their allocable share of wage expenses. UBIA of qualified property is allocated among the partners in the same manner as their allocable share of depreciation expense from the qualified property.

Example 4: Taxable Income Limitation Applicable; Net Loss from Qualified PTP Income for Year Does Not Offset QBI But Is Carried Forward to Next Succeeding Year

Facts: F is an unmarried individual that owns 50% of the stock of Z, an S corporation, and an interest in a PTP. For 2018, F reported total taxable income is $1,880,000. F also has a net loss from qualified PTP income of $10,000. For 2018, Z engaged in a trade or business with QBI of $6 million, W-2 wages of $2 million, and UBIA of $200,000. F's share of QBI, W-2 wages and UBIA, is as follows:

QBI	$3,000,000	
W-2 Wages	$1,000,000	
UBIA	$100,000	

The QBI Component is the lesser of the 20% Component and the Cap. In this case the 20% Component is $600,000, which is 20% of F's distributive share of QBI ($3,000,000). The Cap is the greater of: (i) $500,000, which is 50% of F's allocable share of Z's W-2 wages ($1,000,000), and (ii) $252,500, which is 25% of F's allocable share of the W-2 wages ($1,000,000), or $250,000, plus 2.5% of F's allocable share of Z's UBIA ($100,000), or $2,500. Thus, F's QBI Component is $500,000. F's Section 199A Deduction is limited however to 20% of F's total taxable income , or $376,000 ($1,880,000 multiplied by 20%). Thus, F's Section 199A Deduction for 2018 is $376,000. Highlight: The net loss from the qualified PTP income does not offset the QBI for the year. Instead, the net loss from the qualified PTP income in 2018 will be carried forward to 2019 and used as a net loss from qualified PTP in that year to offset qualified PTP income and qualified REIT dividends in that year, if any. The Section 199A Deduction is not simply the taxpayer's QBI Component. The Section 199A Deduction cannot exceed 20% of the taxpayer's taxable income for the year and qualified net loss from a PTP.

Example 5: QBI Component Adjusted Because Taxable Income Within the Phase-In Range

Facts: B and C are married and file a joint return for 2018. B owns stock in M, an S corporation. M conducted a trade or business in 2018. B's allocable share in 2018 from M of QBI, W-2 wages and UBIA of qualified property is as follows:

QBI	$300,000	
W-2 Wages	$40,000	
UBIA	$-0-	

B and C have taxable income for 2018 of $375,000 as determined after including deductions not otherwise deducted in the business. The taxable income of $375,000 is in the Phase-In Range (i.e, between $415,000 and $315,000), and thus, the QBI Component will be reduced. Analysis: The computation of the Section 199A Deduction is a three step process.

- First Step - Compute the Section 199A Deduction without regard to any adjustments for the Phase-In. In this case, the 20% Deduction is $60,000 (20% multiplied by QBI of $300,000). The Cap limitation is the greater of: (i) 50% of W-2 Wages, $20,000 (50%

multiplied by W-2 wages of $40,000); and (ii) the sum of 25% of W-2 Wages, $10,000 (25% multiplied by W-2 wages of $40,000) plus 2.5% of UBIA, $-0-. Thus, before any adjustments, the QBI Component is $20,000 by reason of the Cap. The excess of the 20% Deduction of $60,000 over the Cap of $20,000, or $40,000, is referred to as the Excess Amount.

- Second Step – Because the taxable income of B and C is within the Phase In, the reduction for the Excess Amount must be adjusted. To compute the adjustment, the Excess Amount of $40,000 is adjusted by multiplying that amount by a fraction in which the numerator is the excess of B's and C's taxable income of $375,000 over the Threshold Amount of $315,000, i.e, $60,000, and the denominator is $50,000 (or $100,000 for joint filers). B and C are joint filers so the fraction of $60,000/$100,000, or 60%. That adjustment percentage of 60% multiplied by the Excess Amount of $40,000 is $24,000.

- Third Step - The QBI Component is $36,000, i.e., an amount equal to the 20% Component of $60,000 is reduced by the adjusted Excess Amount of $24,000.

  B and C are not subject to the taxable income limitation because the QBI Component of $36,000 is less than 20% of their taxable income, or $75,000 (20% multiplied by $375,000).

Example 6: : QBI Component Adjusted Because Taxable Income Within the Phase-In Range and Trade or Business is a SSTB

Facts: Assume the same facts as Example 5 except that M's trade or business is a SSTB. As a general rule, an individual is not entitled to a Section 199A Deduction for QBI from a SSTB. However, the SSTB is treated as a trade or business for which the Section 199A Deduction is allowable provided that their taxable income does not exceed the Threshold Amount, or if it does exceed the Threshold Amount, it is within the Phase In. In the latter instance, an individual's QBI Component must be adjusted as noted below. Analysis: The computation of the Section 199A Deduction is a multiple step computation when the taxpayer's taxable income is within the Phase In Range.

- The first two steps account for the fact that the trade or business is a SSTB and the taxpayer's taxable income is within the Phase In-Range. To emphasize, the first two steps would be unnecessary if the trade or business was a trade or business other than a SSTB.

  1. First Step - To account for the fact that the trade or business is a SSTB and the individual's taxable income is within the Phase-In Range, determine the Applicable Percentage for 2018. The Applicable Percentage in this case is 40%, i.e. 100% minus 60% [which is the percentage equal to the ratio by which B and C's taxable income in excess of the Threshold Amount ($375,000 minus $315,000, or $60,000) bears to $100,000, the Phase-In-Range for married filing jointly)].

  2. Second Step - Adjust the QBI Component for the Applicable Percentage. The QBI of $300,000 after redetermination is $120,000, i.e., $300,000 multiplied by 40% Applicable Percentage. The Excess Amount of $40,000 after redetermination is $16,000, i.e., the Excess Amount of $40,000 (see Example 5 for this calculation) multiplied by 40% Applicable Percentage.

- The next step is necessary because the individual's taxable income is within the Phase-In Range, and applies regardless of whether the trade or business is a SSTB. The Excess Amount of $16,000 multiplied by the 60% adjustment percentage (see Example 5 above). Is $9,600. The Section 199A Deduction would be $14,400 (i.e., the 20% of the QBI of $120,000, or $24,000, less the reduction amount of $9,600). That amount does exceed the 20% of taxable income limitation, or $75,000 (20% of $375,000).

Highlight: This example illustrates that, an individual's QBI Component from a SSTB when the individual is within the Phase-In Range is subject to two adjustments. First an adjustment to account for the fact that trade or business is a SSTB within the Phase-In Range. Second an adjustment to account for the fact that the individuals' taxable income is within the Phase-In Range. If the individual's taxable income was greater than the Ceiling Amount, no Section 199A Deduction would be available. If the taxable income did not exceed the Threshold Amount, none of these adjustments would be necessary.

Example 7: Section 199A Deduction May Be Significantly Reduced Without Choice to Aggregate Trades or Businesses

Facts: F is unmarried, and as a sole proprietor, owns three trades or business, X, Y and Z, none of which is a SSTB. Assume that none of the businesses are aggregated under Prop. Reg. Section 1.199A-4. Assume that for 2018 the businesses have the following QBI, W-2 wages and UBIA in qualified property:

Business	QBI	W-2 Wages	UBIA
X	$1,000,000	$500,000	$-0-
Y	$1,000,000	$-0-	$-0-
Z	$2,000	$500,000	$-0-

Assume that F has taxable income of $2,722,000. Analysis:: The QBI Component for each of X, Y and Z is as follows:

- QBI Component for X: For X, the QBI Component is the lesser of 20% of QBI, or $200,000 (20% multiplied by $1,000,000), and the Cap, or $250,000 (50% of W-2 wages of $500,000). Thus, the QBI Component for X is $200,000.

- QBI Component for Y: For Y, the QBI Component is the lesser of 20% of QBI, or $200,000 (20% multiplied by $1,000,000), and the Cap, or $-0- (50% of W-2 wage of -0-). Thus, the QBI Component for Y is zero.

- QBI Component for Z: For Z, the QBI Component is the lesser of 20% of the QBI, or $400 (20% of $2,000) and the Cap of $250,000 (50% of $500,000). Thus, the QBI Component for Z is $400.

The Section 199A Deduction is the sum of the positive QBI Component for each business, or $200,400. The limitation based on taxable income is not applicable (i.e., the deduction does not exceed 20% of the taxable income of $2,722,000, or $544,400). Highlight: the QBI Component is significantly reduced based on the non-aggregation of the businesses. As explained in Example 8 below, aggregation of the businesses would allow F to take advantage of both the W-2 wages of business Z and the QBI for business Y.

Example 8: Choice to Aggregate Trades or Businesses May Be Beneficial

Facts: Assume the same facts as Example 7 except that F properly chooses under Prop. Reg. Section 1.199A-4 to aggregate the trades or businesses X, Y and Z. Analysis: The QBI, W-2 wages, and UBIA for qualified property after aggregation are as follows:

Business As Aggregated	QBI	W-2 Wages	UBIA
X, Y & Z	$2,002,000	$1,000,000	$-0-

The QBI Component is the lesser of 20% of QBI, or $400,400 (20% multiplied by the combined positive QBI of $2,002,000) and the Cap, or $500,000 (50% multiplied by the combined W-2 Wages, $1,000,000). Thus, the Section 199A Deduction is equal to $400,400. The limitation based on taxable income is not applicable (i.e., the deduction may not exceed 20% of $2,722,000, or $544,400). Highlight: by aggregating the trades or businesses on these facts F's Section 199A Deduction of $400,400 significantly increased over the non-aggregation amount of $200,400.

Example 9 Negative QBI from one Trade or Business Will Offset Positive QBI from another Trade or Business Regardless of Aggregation Choice of Individual

Facts: Assume the same facts as Example 7 except that trade or business Z generates negative QBI of $600,000 and pays W-2 wages of $500,000. F's total taxable income including items of deduction not included in QBI is $2,120,000.

Assume that for 2018 the businesses have the following QBI, W-2 wages and UBIA in qualified property:

Business	QBI	W-2 Wages	UBIA
X	$1,000,000	$500,000	$-0-
Y	$1,000,000	$-0-	$-0-
Z	($600,000)	$500,000	$-0-

Analysis: Because business Z has negative QBI, that negative must be allocated between businesses X and Y in proportion to their respective positive QBI, or 50% for each ($1,000,000/$2,000,000 for both X and Y), or $300,000. As adjusted the QBI for X and Y is $700,000 ($1,000,000 less the allocated portion of Z's negative QBI of $300,000).

- QBI Component For X: The QBI Component for X is the lesser of 20% of X's adjusted QBI, or $140,000 (20% multiplied by the QBI after reduction for Z's loss $700,000); and the Cap of $250,000 (50% multiplied by $500,000 of W-2 Wages). Thus the QBI Component for X is $140,000.

- QBI Component for Y: The QBI Component for Y is the lesser of 20% of Y's adjusted QBI, or, $140,000 (20% multiplied by the QBI after reduction for Z's loss of $700,000); and the Cap of $-0- (50% multiplied by $-0-of W-2 Wages). Thus the QBI Component for Y is $-0-.

- QBI Component for Z: The QBI Component for Z is zero because business Z has negative QBI.

Thus, F's total Section 199A Deduction is $140,000. The limitation of taxable income is not applicable, 20% of $2,120,000 is $424,000, which exceeds the aggregate QBI Component. Highlight: An individual's loss from a trades or business is treated as negative QBI and must be allocated to reduce the positive QBI of other trades or businesses regardless of whether the individual chooses to aggregate the trades or businesses.

Example 10: W-2 Wages and UBIA of Qualified Property of Trade or Business with Negative QBI Still Included in QBI Component When Businesses Aggregated

Facts: Assume the same facts as Example 9 except that F properly chooses to aggregate under Prop. Reg. Section 199A-4 all of its trades or businesses. Analysis: On these facts, the positive QBI and negative QBI are netted as follows:

Business Aggregated	QBI	W-2 Wages	UBIA
X, Y & Z	$1,400,000	$1,00,000	$-0-

F's QBI Component would be the lesser of: (i) 20% of the combined QBI, or $280,000 (20% of aggregate QBI of $1,400,000); and (ii) the Cap, or $500,000 (50% of aggregate W-2 wages of $1,000,000). The Section 199A Deduction is $280,000 and is not subject to the taxable income limitation (20% of 2,120,000 of taxable income, or $424,000, is greater than QBI Component). Highlight: As with Example 8, aggregations on these facts has produced a greater 199A Deduction. F was able to increase the W-2 wages Cap by including Z W-2 wages even though Z produced negative QBI. Stated differently, the fact that Z had a negative QBI does not preclude the use of its W-2 wages in calculating the aggregate QBI Component.

Example 11: Cumulative Negative QBI Will Carry Forward to Next Succeeding Year as a Loss in that Year

Facts: Assume the same facts as Example 7 except that the trades or businesses have the following results of operations for 2018 and 2019.

Tax Year 2018			
Business	QBI	W-2 Wages	UBIA

X	$1,000,000	$500,000	$-0-
Y	$1,000,000	$-0-	$-0-
Z	($2,150,000)	$500,000	$-0-

Tax Year 2019			
Business	QBI	W-2 Wages	UBIA
X	$200,000	$100,000	$-0-
Y	$150,000	$-0-	$-0-
Z	(120,000)	$500	$-0-

Business are not aggregated. F's taxable income for 2018 and 2019 is $2,722,000 and $960,000, respectively.

Analysis For 2018: The QBI Component for 2018 is zero computed as follows.

- First, the negative QBI of Z exceeds the aggregate positive QBI of X and Y by $150,000, so that there is an overall negative QBI of ($150,000). With a cumulative negative QBI for 2018 there is no Section 199A Deduction for the year. Moreover, the ($150,000) negative QBI will carry over to 2019 and be treated as negative QBI from a separate trade or business in 2019.

Analysis For 2019: The QBI Component for 2019 is

- The Proposed Regulation provide that the ($150,000) loss may be used to offset F's other taxable income, subject to other limitations under the Code on such loss (e.g., Section 465 and Section 469). Analysis: Note that loss allocation from 2018 carried over as a separate trade or business and the loss from Z in 2019 are allocated to X and Y in proportion to their respective positive QBI, or 200/350 for X and 150/350 for Y. The specific allocations are set forth in the table below.

2019/Loss Allocation	QBI Before Loss Reduction	Loss Allocation from 2018 Carryover of $150,000	Loss Allocation from 2019	Positive QBI After Loss Reduction

X	$200,000	($85,715)[255]	($68,571)[256]	$45,714
Y	$150,000	($64,285)[257]	($51,429)[258]	$34,286
Z	($120,000)			

- QBI Component for X: The QBI Component for X is the lesser of: (i) the 20% of QBI of $45,714, or $9,143 (20% of $45,714); and (ii) 50% of the W-2 Wages, $50,000 (50% of $100,000). Accordingly, the QBI Component for X is $9,143.

- QBI Component for Y: The QBI Component for Y is the lesser of: (i) the 20% of QBI of $34.286, or $6,857 (20% of $34,286); and (ii) 50% of the W-2 Wages, or $-0- (50% of W-2 Wages of $-0-). Accordingly, the QBI Component for Y is $-0-.

- QBI Component of Z: The QBI Component of Z is zero because Z has negative QBI for the year.

The aggregate QBI Component for X and Y is $9,143. That amount is not limited by F's taxable income for 2019 (20% of $960,000, or $192,000). Highlight: This example illustrates how negative QBI for one business is used to reduce the positive QBI from other trades or business and the carryover of an overall negative QBI to the subsequent year.

Example 12: Benefits of Aggregation and Impact of Negative QBI of Trade or Business

Facts: Assume the same facts as Example 11 except that F properly chooses under Prop. Reg. Section 1.199A-4 to aggregate X, Y and Z. Analysis:

QBI for 2018: The QBI Component for 2018 will be the same as under Example 11 because the cumulative QBI for X, Y and Z is a negative $150,000. The QBI Component is the lesser of: (i) 20% of the QBI, which in this case was negative; and (ii) 50% of the W-2 Wages, or $500,000 (50% of $1,000,000). Accordingly, the QBI Component for 2018 is $-0-. There is a carryover of $150,000 negative QBI to 2019 which is treated as a negative QBI from a separate trade or business.

QBI for 2019: The combined positive QBI for X, Y and Z for 2019 is $80,000 (i.e., the sum of the positive QBI for X and Y of $200,000 plus $150,000 minus the negative QBI from the carryover of $150,000 and the negative QBI for Z for 2019 of $120,000. The QBI Component is the lesser of: (i) the 20% of the cumulative QBI of $80,000, or $16,000 (20% of $80,000); and (ii) 50% of the W-2 wages, or $50,250 (50% of the aggregate W-2 wages of $100,500). The lesser of the amount is $16,000, and thus, the Section 199A Deduction for 2019 is $16,000. This amount is not subject to the taxable income limitation (20% of $960,000, or $192,000). Highlight: This example

[255] ($150,000) multiplied by $200,00/$350,000 = $85,715).
[256] ($120,000) multiplied by $200,000/$350,000=($68,571).
[257] ($150,000) multiplied by $150,00/$350,000 = ($64,285).
[258] ($120,000) multiplied by $150,000/$350,000=($51,429)

demonstrates the benefit of aggregation of trades or businesses under the right facts. It also illustrates how to account for negative QBI that is carried over from a prior year and negative QBI generated in the current year.

A.18.11.3 Proposed Regulation Section 1.199A-2(c)(4) Example regarding determination of UBIA with respect to qualified property. Unless otherwise stated assume that the trade or business is not a SSTB.

Example 1: UBIA in Computing the Cap Is Not Adjusted by Depreciation

Facts: Assume on January 5, 2012, individual A purchases for use in A's trade or business depreciable real property X for which A has a tax basis determined under Section 1012 of $1 million. Assume further that at the end of 2018, A's depreciable basis with respect to X of $821,550. Assume that the property X in 2018 is qualified property under Section 199A. Analysis: For the calendar year 2018, A's UBIA in X is $1 million. Highlight: Illustrates that if an individual or RPE purchases qualified property and uses it in a trade or business, depreciation taken by that person will not reduce its UBIA for purposes of the Cap. As explained below, however, if the individual or RPE contributes the qualified property to an RPE and the RPE takes a carryover basis under Section 723 in the property, the UBIA will be its tax basis as adjusted for deprecation.

Example 2: UBIA and Qualified Period for Replacement Property in Like-Kind Exhange

Facts: Assume the same facts as Example 1 except that on January 15, 2019, A swaps property X for property Y in a like-kind exchange under Section 1031. Property X and Y both have a value of $1 million and no boot is exchanged. Finally, assume that on January 15, 2109, A's depreciable basis in property X is $820,482 as determined under Section 1031(d). Analysis: For purposes of determines the depreciable period in computing the Cap for UBIA, property Y is treated as first placed in service on January 5, 2012, under Prop. Reg. Section 1.199A-2(c)(2)(i)(A). A’s UBIA in Y is $820,482. Highlight: Note that the UBIA of Y is A’s adjusted basis in X of $820,482, and assuming a depreciable period of 10 years) the depreciable period will end as of the close of the 2021. Even though A’s UBIA in X is $1,000,000, as a result of the like-kind exchange the UBIA in Y is its adjusted basis. Why does this depreciable period end in 2021 rather than 2022? The depreciable period must not have ended before the close of the A's taxable year. For X the depreciable period would end in January 15, 2022, but that is before A's year end for 2022 of December 31, 2022. Thus, 2021 is treated as the depreciable period, provided of course that the recovery period on the property has not run earlier.

Example 3: UBIA in Transferred Basis Property in Contribution to S Corporation

Facts: Assume individual C operates a trade or business as a sole proprietorship. On January 5, 2011, C purchases machinery Y for use in the business with a basis under Section 1012 of $10,000 and recovery period under Section 168(c) of 10 years. Assume that machinery Y is qualified property. Assume further that at the close of 2018 C's tax basis in qualified property, as adjusted for depreciation, is $2,500. On January 1, 2019, C incorporates the sole proprietorship in a non-recognition transaction under Section 351 and elects to classify the corporation as an S corporation. Analysis: C's UBIA in machinery Y is $10,000, notwithstanding the prior depreciation. However, on the transfer of machinery Y to the corporation, the corporation's UBIA is $2,500, the basis of the property under Section 362 at the time the corporation places the property in service. The qualified period for machinery Y begin January 5, 2011 and will end for the corporation's taxable year end in 2020. Note even though the 10 year period would run from

January 2, 2011, to January 2, 2021, the machinery ceases to be qualified property in 2020 because the depreciable period ending January 2, 2021 is before the close the C's taxable year ended December 31, 2021. See Prop. Reg. Section 1.199A-2(c)(1)(i)(C). Highlight: An S corporation that receives qualified property in a contribution from a shareholder in a transaction in which under Section 362 the corporation's adjusted basis is the same as the shareholder's basis will have an UBIA in the contributed property determined by reference to the shareholder's tax basis as adjusted for depreciation. Thus, while the shareholder's UBIA in the property immediately before the contribution is unadjusted by prior depreciation (including bonus depreciation), when the property is contributed to the S corporation, the corporation's UBIA is determined by reference to the partner's adjusted tax basis in the property, as adjusted for depreciation including bonus depreciation. Also, the depreciable period begins on the date the shareholder placed the contributed property in service. Note that if the transferee's basis in the contributed property exceeded the transferor's tax basis, the excess would be be treated as separate property placed in service at the time of the acquisition. Also, while this example is a contribution of property from a shareholder ot an S corporation, the same rules would apply to a contribution of property from a partner to a partnership in a transaction in which the property had a basis determined under Section 723.

A.18.11.4 Proposed Regulation Section 1.199A-4(d) Examples on aggregation rules

Unless otherwise stated, assume for all examples that: (i) all trades or businesses satisfy the requirements of Section 162; (ii) all individuals are citizens of the U.S. and use the calendar year; (iii) all businesses are domestic; (iv) none of the businesses are SSTB; and (v) there are no ownership changes during the relevant periods.

Example 1: Aggregation of Trades or Businesses Permitted

Facts: Assume individual A owns through disregarded entities a catering and a restaurant business. The businesses share accounting and purchasing departments. Advertising includes references to both businesses. Each business uses the same kitchen but otherwise has separate employees and equipment. Analysis: A may choose to aggregate the businesses because: (i) the businesses are commonly controlled, i.e., A owns 100% of both businesses through separate disregarded entities; (ii) the common ownership exists throughout the tax year of A; (iii) both businesses are disregarded entities and their income is included in A's taxable income; (iv) none of the businesses are SSTB; and (v) the business provided products and services commonly offered together, i.e., prepared food; and the businesses share a common accounting and same kitchen facility. Highlight: Example illustrates basis rules for aggregating qualified trades or businesses.

Example 2: Aggregation of Trades or Businesses Operated Through Multiple RPE Permitted with Common Control of RPEs

Facts: Assume same facts as Example 1 except each business is owned in a separate partnership and that each partnership is owned 25% by A and the remaining 75% owned equally by three unrelated taxpayers. Analysis: A may choose to aggregate the businesses conducted through separate partnerships because both partnerships are commonly controlled. Common control under the Proposed Regulations requires that the same person or group of persons own 50% or more of the profits or capital of the partnership. In this case, each partnership is 100% owned by the same four taxpayers. Analysis: This example illustrates the common control requirement in the context of commonly controlled partnerships. Note the example only focuses on A's choice to aggregate and does not address the choice of the other partners regarding aggregation. This highlights that under the aggregation rules multiple owners are not required to make the same decisions on whether to aggregate commonly owned businesses.

Example 3: Aggregation May Not Be Permitted Even With Common Ownership

Facts: Assume that individual W owns 75% of the stock of S1, an S corporation, and 75% of the profits and capital of PRS, a partnership. S1 is in the business of manufacturing cloths and PRS is a retail pet food store. Analysis : W is not permitted to aggregate the businesses conducted through S1 and PRS. Aggregation is not permitted because W cannot satisfy at least two of the requirements under Prop. Reg. Section 1.199A-4(b)(1)(v), i.e., services commonly provided or offered together, common centralized business functions, or businesses operated in coordination or reliance on one or more of the aggregated businesses (i.e., commonality of operations). In this case, the businesses satisfy none of those requirements. Highlight: Even though the businesses meet the common control requirement-because W owns more than 50% of the stock of S-1 and of the capital and profits of PRS, aggregation is not permitted. There must be some commonality in operations between the businesses sufficient to meet the requirements of Prop. Reg. Section 1.199A-4(b)(1)(v).

Example 4: Aggregation Permitted: Individual Free to Choose Trades or Businesses to be Aggregated; Aggregations made at Individual Owner Level and not by an RPE

Facts: Assume individual E owners 60% of the profits and capital in each of 4 partnerships, PRS1, PRS2, PRS3 and PRS4. Each partnership operates a hardware store. The same human resources and executive management team oversees all of the partnerships. E chooses to aggregate all of the partnerships other than PRS4. PRS4 operates at a loss. Analysis: E's aggregation of the partnerships is permitted under the Proposed Regulations. Even though E satisfies all of the aggregation requirements for all 4 partnerships, E may decide which partnerships to include in the aggregation, such as in this case to exclude PRS4 from the aggregation with the remaining partnerships. E presumably could choose to aggregate PRS1 and PRS2, and in a separate aggregation PRS3 and PRS4. Even though PRS4 is not included in the aggregation, PRS4's loss nonetheless must be allocated to each of the other businesses of PRS1, PRS2 and PRS3 in proportion to their respective amounts of QBI, which allocated amounts serves to reduce the QBI for each of the other partnerships. A taxpayer cannot avoid reducing combined QBI in computing the Section 199A Deduction by failing to include a loss business in a grouping of profitable businesses.

Example 5: Aggregation Permitted: Common Ownership under Aggregation Rule

Facts: Assume the same facts as Example 4 except F owns 10% of each of the partnerships. Analysis: F is permitted to aggregate any of the businesses conducted by the partnerships because the common control requirement is satisfied. The same persons (E and F) own 50% or more of the capital or profits of the partnerships. Highlight: F is not separately required to be in common control of the businesses to aggregate. Rather, the common control requirement is satisfied if the same persons, in this case E, owns 50% or more of the capital or profits of the partnerships.

Example 6: Aggregation Not Permitted for Trades or Business Without Common Operations or Coordination

Facts: Assume individual D owns 75% of the stock of three S corporation, S-1, S-2 and S-3. Each S corporation operates a grocery store in a separate state. S-1 and S-2 share common centralized functions of accounting, purchasing and payroll. S-3 does not share any of such common functions. Assume D satisfies all of the other aggregation requirements. Analysis: Only the businesses conducted by S-1 and S-2 may be aggregated. The business operated by S-3 does not satisfy the common operations test of Prop. Reg. Section 1.199-4(b)(1)(v). Highlight: The taxpayer must be able to satisfy the common operations test in Prop. Reg. Section 1.199A-4(b)(1)(v) among businesses that the individual wishes to aggregate.

Example 7: Aggregation Not Permitted; Trades or Business Do Not Share Common Operations or Coordination

Facts: Assume the same facts as Example 6 except none of the businesses share in common operations of centralized accounting and payroll. Analysis: D is not permitted to aggregate any of the businesses. Highlight: The individual must be able to satisfy the common operations test in Prop. Reg. Section 1.199A-4(b)(1)(v) among businesses the taxpayer wishes to aggregate.

Example 8: Aggregation Permitted: Trades or Businesses Share Common Operations or Coordination

Facts: Assume individual G owns 80% of the stock of S-1, an S corporation, and 80% of the capital and profits of two limited liability companies taxed as partnerships, LLC-1 and LLC-2. Assume further that LLC-1 manufactures widgets sold to LLC-2 for resell in LLC-2's retail store and S-1 leases facilities to each of LLC-1 and LLC-2. Finally, assume that all of the businesses share common advertising and management. Analysis: All of the requirements to permit aggregation are satisfied for the businesses operated by each of the limited liability companies and the S corporation. Highlight: The leasing of the facilities by S-1 is treated as a trade or business by reason of Prop. Reg. 1.199A-1(b)(13). The example concludes that LLC-1, LLC-2 and S-1 are operated in coordination or reliance upon each other and share common operations of advertising and management. Recall that the common operations requirement is satisfied only if two of the following three tests are satisfied: (i) products or services commonly provided together; (ii) common management, accounting, etc., or (iii) the businesses are operated in coordination with or reliance upon one or more of the businesses in the group. S-1 does not satisfy the requirements for products or services commonly provided together but does share common operations of advertising and management. However, S-1 must also satisfy one other of the three requirements in order to aggregate. It appears that S-1 leasing of facilities is treated as operated in coordination with or reliance upon LLC-1 and LLC-2.

Example 9: Aggregation Permitted: Attribution Rules for Common Control Test

Facts: Assume the same facts as Example 8 except that G owns 80% of the stock of S-1 and 20% of the capital and profits of LLC-1 and LLC-2. Assume further that G's son owns more than 50% of the profits and capital of LLC-2 and G's mother owns more than 50% of the profits and capital of LLC-1. Analysis: G has common control of the businesses because the son's capital and profits interest in LLC-2 and the mother's profits and capital interests in LLC-1 are attributed to G. Prop. Reg. 1.199A-4(b)(3). As explained in Example 8 the other requirements for aggregation are satisfied. Highlight: Illustrates application of attribution rules provided by Prop. Reg. Section 1.199A-4(b)(3). The Proposed Regulations provide attribution rules and do not rely on the attribution rules found elsewhere the Code. Although not stated, presumably the son and mother could aggregate the businesses as well.

Example 10: Aggregation Permitted: Minority Owner in Multiple RPEs May Choose to Aggregate

Facts: Assume five partnerships (PS-1 through PS-5) the profits and capital interests of which are owned 75% by individual F and 5% by individual G. Individual H owns a 10% interest in capital and profits of PRS-1 and PRS-2, but has no interest in the other partnerships. Each partnership conducts a restaurant business that is a trade or business under Section 162. G is the chief executive of all of the businesses and creates menus and orders supplies. Analysis: The common control requirements is satisfied for both F and G for all five partnerships, i.e., the same persons, G and F own 50% or more of the capital and profits interests in all of the partnerships. With respect to H, however, common control only exists for PRS-1 and PRS-2 which are the two partnership in which H holds an interest. Moreover, all of the partnerships satisfy the common operations requirements because the businesses are all in the same business (Prop. Reg. Section 1.199A-4(b)(1)(v)(A)) and all are operated under the same chief executive and have centralized function for ordering food and supplies (Prop. Reg. Section 1.199A-4(b)(1)(v)(B). Analysis: Businesses may be aggregated by owners that satisfy the common control test with all such businesses. Even though H only owns a 10% profits and capital interest in two of the partnership, those partnerships are nonetheless under common control through the ownership of F and G, and H may choose to aggregate those partnerships in which he has an interest.

Example 11: Aggregation Permitted: Individual Owners Not Required To Make Same Aggregation Choices

Facts: Assume four individuals, H, J, K and L own a capital and profits interest in two partnerships, PRS-1 and PRS-2, stock in two S corporation, S-1 and S-2, and stock in a C corporation, C. Each of H, J, K and L own the same percentage interest in all of the entities: H owns 30%, J owns 20%, K owns 5%, L owns 45%. Assume all five of the entities satisfy the common operations or coordination requirements in Prop. Reg. Section 1.199A-4(b)(1)(v). The individuals choose different aggregations.

H aggregates PRS-1 and S-1 into one group, PRS-2 and S-2 into another group.

J aggregates PRS-1, S-1 and S-2 into one group, and reports PRS-2 separately.

K aggregates PRS-1, PRS-2 into one group, and reports S-1 and S-2 together as a separate aggregated group.

L aggregates S-1, S-2 and PRS-2 into one group and reports PRS-1 separately.

C cannot be included in any aggregation.

Analysis: Each of the partnerships and S corporation in which H, J, K and L own interests are under common control within the meaning of Prop. Reg. Section 1.199A-4(b)(1)(i). The aggregations reported by each of the individuals is permitted but not required under the aggregation rules. Analysis: Illustrates application of common control test in a complex ownership arrangement. Emphasizes that a C corporation cannot be included in the aggregation under any circumstances.

Example 12: Aggregation Not Permitted: Only Trades or Business May Be Aggregated and Non-Trade or Business Activity May Not Be Aggregated With Trades or Businesses

Facts: Assume that individual C owns a majority interest in a sail boat team and a majority interest in a partnership operating a marina. The partnerships' businesses is a trade or business within the meaning of Section 162 but the sail boat team is not. Analysis: Only trades or businesses may be aggregated. Accordingly, the marina operations and sail boat team may not be aggregated. Highlight: The activity must rise to the level of a trade or business within the meaning of Section 162 in order to be aggregated.

Example 13: Aggregation Permitted: Coordination Test Satisfied

Facts: Assume a trust owns all of the capital and profits interests in three limited liabilities companies taxed as partnerships, LLC-1 through LLC-3. LLC-1 operates a trucking business that delivers lumber to LLC-2 that operates a lumber yard. LLC-3 operates a construction company and LLC-2 provides LLC-3 with lumber. All of the limited liability companies are operated under centralized human resources, accounting and payroll departments. Analysis: Trust satisfies the common operations or coordination test of Prop. Reg. 1.199A-4(b)(1)(v). First, the businesses share centralized human resources, accounting and payroll departments. Second, the businesses are operated in coordination and reliance on one more businesses in the aggregated group. LLC-1 uses its trucking operation to supply LLC-2; LLC-2 sells its lumber to LLC-3 for use LLC-3's construction business. Highlight: Example illustrating the requirements of coordination and reliance among the businesses to be aggregated.

A.18.11.5 Proposed Regulation Section 1.199A-5(b)(3) Example illustrating the rules regarding the definition of SSTB

Unless otherwise stated assume that individuals referenced have taxable income in excess of the Threshold Amounts.

Example 1 Field of Performing Arts:

Facts: Assume that A, a singer, records a song and is paid a royalty whenever the song is licensed or streamed or when the song is played publicly. Analysis: A is engaged in a SSTB by reason of being engaged in the field of performing arts. Highlight: This example illustrates the meaning of performing arts for purposes of Section 199A.

Example 2 Field of Athletics

Facts: Individual B is a passive partner in a partnership that owns and operates a professional football team. In that connection, the partnership employees the players, arranges games and sells tickets. Analysis: The partnership is a SSTB by reason of engaging in a trade or business in the field of athletics. B is not entitled to a Section 199A Deduction with respect to B's distributive share of partnership items. Highlight: This example illustrates the meaning of the term "field of athletics." Also, if an RPE is engaged in a SSTB, any owners distributive share of the entity's items will not qualify for a Section 199A Deduction unless such individual’s taxable income is below the Ceiling Amount. The owners do not have to be engaged directly in the SSTB to be subject to the limitation on the Section 199A Deduction as long as the entity is engaged in the SSTB.

Example 3 Field of Consulting

Facts: C is in the business of assisting clients in making their personnel structures more efficient. After C has studied a client's organization structure, C compares the structure to C's industry peers, and then makes recommendations regarding personnel structure, including the use of temporary workers. Analysis: C is engaged in the field of consulting by reason of advice to clients on achieving goals. Highlight: This examples illustrates the meaning of the term "field of consulting." There is nothing particularly remarkable about the conclusion of the example but the elaboration in the example that C advised on the use of temporary workers interesting is curious.

Example 4 Field of Consulting: Individual Not Engaged

Facts: D is engaged in the business of licensing software to customers. D advises the customers regarding its software and assists in the customers implementation of the software. D is paid a flat fee for the each license. Analysis: D is not engaged in the field of consulting. D is engaged in the business of licensing its software which is not itself a SSTB. Highlight: This is the first example in which the taxpayer was not engaged in a SSTB and is an example that limits the meaning of field of consulting. The example made clear that D had customers, not clients and that it was paid a flat price for a license, not fee for services. The example stays away from any mention of D's advice to a customer on achieving the customer's objectives or goals although clearly D must have been offering such advice.

Example 5 Field of Financial Services

Facts: E is engaged in the business of assisting clients with their finances. The business includes reviewing the clients financial situation and future financial objectives and then advising on budgets, investment strategies and similar services to meet the objectives. Analysis: E is engaged in providing financial services. Highlight: This example illustrates the meaning of field of financial services. It would appear that the individual could just as well of been performing services within the field of consulting. Note also that there were no sales activities involved.

Example 6 Field of Brokerage Services

Facts: F is engaged in the business of trading securities and commodities for customers. F advises customers on trades and effects the trades through exchanges or similar networks. F's compensation is typically based on completion of trades. Analysis: F is engaged in the field of brokerage services. Highlight: Example illustrates meaning of field of brokerage.

Example 7 Reputation and Skill of Employees and Owners

Facts: Individual G through a wholly-owned S corporation operates a trade or business that engages in the sales and repairs of bicycles. The corporation's assets consists of inventory, fixtures, repair equipment and leasehold on the location. Several of the corporation's employees and G have acquired substantial skill and reputation in the field and often consult with customers. Analysis: The corporation's trade or business is not a SSTB. Highlight: The reputation and skill of G and other employees did not cause the business to be classified as a SSTB. The conclusion was not a hard one because the Proposed Regulations clearly limit the a trade or business where a principal asset is a skill or reputation of one or more the employees or owners to a very limited situation described in Prop. Reg. Section 1.199A-5(b)(2)(xiv).

Example 8 Reputation and Skill of Employees and Owners

Facts: H is a chef that owns and operates through a disregarded entity multiple restaurants. H is well known and receives endorsement fees for use of his name on cooking utensils. Analysis: H is in two trades or businesses. The first is the restaurant business and it is not a SSTB. The other business is endorsement of cooking utensils and is a SSTB by reason of the skill and reputation of H. Highlight: What is interesting is that Treasury divided the business in to two businesses, endorsement and restaurant. The endorsement business fit squarely within Prop. Reg. Section 1.199A-5(b)(2)(2)(xiv)(A)(i.e., a person receiving a fee for endorsing products). The good news is that there is nothing in the facts to suggest that H operates the restaurants and endorsements as separate businesses or maintained separate books and records. Nonetheless, the Treasury on its own volition concluded the businesses were separate, one a SSTB and one not a SSTB.

Example 9 Reputation and Skill of Employees and Owners

Facts:

J is an actor and entered into a partnership with a retailer in the business of selling shoes. J agreed to contribute her likeness and use of her name to the partnership in exchange for a 50% capital and profits interests and a guaranteed payment. Analysis: J's trade or business consisting of the receipt of a partnership interest in exchange for the use of J's name and likeness was a SSTB. Highlight: The conclusion that J's business was a SSTB was not surprising on these facts. Prop. Reg. Section 1.199A-5(b)(2)(xiv)(B) makes clear a SSTB includes a person's receipt of other income for the use of an individual's likeness or name. Moreover, Prop. Reg. Section 1.199A-5(b)(2)(xiv)(D) makes clear that fees, compensation and other income include the receipt of a partnership interest and distributive share of items therefrom. What is not stated by the example is whether the partnership itself was engaged in a SSTB such that owners besides J would not be entitled to a Section 199A Deduction. What the example says is that "J's trade or business consisting of the receipt of the partnership interest and the corresponding distributive share" was a SSTB.

A.18.11.6 Proposed Regulation Section 1.199A-5(c)(2)(iv): Example illustrating the rules regarding the definition of SSTB with respect to so called "crack and pack" transactions

Example: “Crack-and-Pack” Transaction

Facts: Taxpayer is a law firm that owns its own office building and employs an administrative staff. Taxpayer divides into three partnerships, P-1 performs traditional legal services for clients, P-2 owns the office building that it leases to P-1, and P-2 employs the administrative staff that provides administrative services to P-1 for a fee. All of the partnerships are owned by the same persons. Analysis: Because the partnerships are commonly controlled, and P-2 and P-3 provide more that 80% of their property or services to P-1, P-2 and P-3 are classified as SSTB. Highlight: P-2 and P-3 would not be on a standalone basis (i.e., if not commonly controlled by P-1) a SSTB. However, because P-2 and P-3 are commonly owned with P-1, an entity that clearly is a SSTB (i.e., a law firm) and their property and services are consumed only by P-1, then P-2 and P-3 are also SSTBs. The "crack and pack" planning to structure P-2 and P-3 to avoid SSTB will not work under the Proposed Regulations. Interestingly, the answer would be the same regardless of whether the structure predated the 2017 Act and had been done for significant business reasons unrelated to tax.

A.18.11.7 Proposed Regulations Section 1.199A-5(b)(c)(3)(ii): Example Illustrating When an Entity Commonly Controlled with an SSTB Will Be Incidental to that SSTB

Facts: A dermatologist, A, conducts his medical practice through a disregarded entity. A also sells skin care products to A's patients. The same office staff and office space is used for both the medical practice and the sale of the products. The gross receipts from the skin care products does not exceed 5% of the total gross receipts from the total aggregate sale of both the medical practice and product sales. Analysis: The medical practice and the activity of selling skin care products are wholly-owned by A. A is engaged in a SSTB, i.e., the field of health. Both activities share office space and staff, and the sale of products produce gross receipts of less than 5% of the aggregate gross receipts from both activityies. Accordingly, the sale of products is incidental to the SSTB, and thus, is part of the SSTB. Highlight: Another instance of guardrails established by the Treasury to prevent taxpayers from circumventing the SSTB by trying to split ancillary activities of a SSTB into a different business. The limitation is aimed at activities under common control, shared overhead type costs and limited gross receipts from the ancillary activity.

A.18.11.8 Proposed Regulation Section 1.199A-5(d)(3)(i): Examples illustrating Proposed Regulations Attack on Attempted Transmogrification of Employee to Non-Employee for purposes of Section 199A

Example 1: Non-Employee Status Denied

Facts: PRS, a partnership, employs A as a full time employee. A terminates his employment as an employee with PRS and enters into a contract with PRS (presumably as an independent contractor, although the example does not expressly say so). A continues to perform the same services for PRS. Analysis: Notwithstanding the supposed change in A's status from employee to that of independent contractor, A is nonetheless presumed under the Proposed Regulations to be an employee with respect to PRS, and therefore, precluded from reporting a Section 199A Deduction with respect to A's income from PRS. The example also provides that this conclusion follows even if A had formed an S corporation and the S corporation contracted with PRS for the provision of A's services. Highlight: The Treasury is serious about taxpayers trying to change the label of employee into another relationship to achieve a Section 199A Deduction. But note the rule only establishes a presumption that the new relationship continues to be that employee-employer and can be overcome by a showing the services are other than in a capacity as an employee.

Example 2: Non-Employee Status Denied; Presumption of Employee Status Not Rebutted

Facts: C is an associate - employee - in a law firm organized as a partnership, LF-1. C and other associates of LF-1 form another law firm, LF-2. LF-2 contracts with LF-1 to perform legal services. The example assumes that C and the other associates continue to provide within LF-2 the same services for LF-1 that they did before the reorganization. Analysis: C and the other associates are presumed to continue to be engaged in the trade or business of performing services as employees because they continue to perform indirectly through LF-2 the same services for LF-1 that they did directly as LF-1's employees. Therefore, C's distributive share of income from LF-2 is not treated as QBI and no Section 199A Deduction is allowed. The example notes that the same answer follows if LF-2 was admitted as a partner in LF-1. Highlight: The Treasury is serious about taxpayers trying to change the label of employee into another relationship to achieve a Section 199A Deduction. One interesting side note is that the manner in which the Treasury established the guardrail only applies it to current employees of a SSTB for which the employment relationship is changed. It does not by its terms apply to new hires. For example, assume same facts as Example 2 except that a lawyer is admitted as a partner in LF-2 that has no prior relationship with LF-1. Also, note that LF-2 is not commonly owned by the partners of LF-1. However, the presumption applies because it covers instances in which the employee performs the same services either directly or indirectly for the original employer LF-1. In this case, C is performing the same services for LF-1 indirectly through LF-2.

Example 3: **Non-Employee Status Accepted; Presumption of Employee Status Rebutted**

Facts: E is an engineer employed by an engineering firm, EF, organized as a partnership. Normally, EF considers its engineer employees for partnership after 10 years of service. As an employee, E is treated for purposes of Section 199A as being in the trade or business of performing services as an employee, and therefore, E's wages do not qualify for the Section 199A deduction. However, if E were a partner, E's distributive share would qualify for the Section 199A Deduction (recall the field of engineering is not a SSTB). Assume that E becomes a partner in EF in the normal course after 10 years. Assume further that E otherwise satisfies requirements under Federal tax law (including common-law employee classification) to be respected as a partner. Analysis E is presumed to be engaged in the trade or business of being an employee and would not qualify for the Section 199A Deduction. However, E is able to overcome the presumption by demonstrating the E became a partner as a career milestone and satisfies the requirements of Federal tax laws (including common-law employee classification rules) to be a partner. Thus, E's distributive share of items from EF would qualify for a Section 199A Deduction assuming other requirements of that section were satisfied. Highlight: The presumption of employee status applies even in instances in which the change in status from employee to partner was consistent with long-standing practices of promotion of employee to partner. The presumption must be overcome in order for the individual to qualify for the Seciton 199A Deduction. This presumption could be interesting in connection with IRS audits.